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**PLANNED ECONOMIES?**  
**CORPORATIONS, TAX AVOIDANCE AND WORLD**  
**POLITICS**

**Matti Ylönen**

ACADEMIC DISSERTATION

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# ABSTRACT

The power of Multinational Enterprises (MNEs) has become a major policy issue and an emerging topic in social sciences. Accounts of corporate tax avoidance, monopolistic practices of big tech companies, and mishandling of data by social media giants permeate the news. However, social scientists and business scholars have struggled to conceptualize the agency and governance of these increasingly powerful supranational entities. I tackle this theme by analyzing the challenges that corporate tax avoidance creates for the established concepts of global governance and for the ways in which MNEs are conceptualized within International Political Economy (IPE).

While recent years have seen a growing interest in the study of the political aspects of MNEs and their tax avoidance capabilities, many of these findings are not as novel as they seem. The introductory chapter illustrates the complex and largely forgotten transdisciplinary history of tax avoidance and corporate power. The introduction demonstrates how scholarship on corporate power began with the birth of evolutionary economics, and how scholars such as Thorstein Veblen and John R. Commons discussed issues such as the tax aspects of immaterial rights — a highly topical theme today — already in the early 1900s.

I trace the evolution of the scholarship on corporate power through the writings of Berle, Means, Galbraith, Hymer, Baran, Sweezy and other scholars associated with evolutionary economics, early International Business and Marxist studies. I also highlight the often-neglected role that policy-related research had in the analyses of corporate power within early evolutionary economics, as well as the supranational research conducted within the United Nations Centre on Transnational Corporations (UNCTC) and its subgroups. By the end of the 1970s, a surprisingly mature understanding had emerged on international corporate tax avoidance and the powers it granted to MNEs over states. Ultimately, these findings were forgotten in the changing political-economic climate of the 1980s. I argue that within IPE, the Open Economy Politics approaches of the 1990s left little room for analyzing corporate power.

The first self-authored article of the dissertation analyses various groundbreaking policy proposals and analyses published by UNCTC and — to a lesser extent — the OECD in the 1960s–70s on corporate tax avoidance and corporate power. I argue that the decision of the Reagan administration to withdraw funding from UNCTC and the overall shift in economic policy thinking contributed to the shattering of the policy community around UNCTC. The second co-authored article develops a new methodology, qualitative financial accounts research, to uncover the ways in which MNEs employ complex international tax avoidance policies. By utilizing an industry-wide tax-avoidance case study, the article highlights the role of immaterial rights in corporate wealth chains.

The third co-authored article turns attention to a yet another major institution in economic governance, namely WTO. The article focuses on two cases brought to WTO's dispute resolution system by Panama. These case studies enable the analysis of the interrelationships of global tax governance and global trade governance, which has remained a virtually unexplored area in tax governance scholarship. As in the previous article, this paper also demonstrates a new method of gaining insight into tax avoidance, while also bringing into question some of the established proposals on how to regulate the problem. Finally, the article suggests new ways for further developing the theory of new constitutionalism.

The fourth co-authored article operates at a different level by bringing a focus on the freedom enjoyed by large MNEs to determine where to book their profits, which carries a major impact on tax revenues, regulation and transparency. It is proposed that this intra-firm cross-subsidization should be perceived as a form of economic planning, and hence, as a political process that introduces new questions on the accountability and political nature of MNEs. Yale University granted this article the Amartya Sen prize in 2015.

The penultimate, single-authored article further examines the undiscovered overlapping of global tax governance and other forms of international economic governance. It also proposes a novel approach for research on MNEs and their governance by focusing on a new set of case materials — IMF's various country-level assessments — covering a timespan of nearly two decades in three countries. IMF, in a similar vein to WTO, is often described as a possible site for regulating transnational tax avoidance. I argue that any effort along these lines is likely to focus on individuals rather than the MNEs which are the most likely to engage in such practices. This is a forward-looking paper that demonstrates the importance of detailed and in-depth case analysis over merely looking at the stated intentions of particular organizations — a recurrent theme of the dissertation.

The final, also single-authored, article turns to a yet another set of institutions that could serve as potential regulators of multinational enterprises. I make the case that city-level procurement policies can be effective tools in a transnational push for fair taxation of MNEs — but only under stringent conditions.

Overall, the dissertation can be read as a global tour of the instruments that could be used to tackle the seemingly intractable problem of the global governance of MNEs and their tax avoidance, and the theoretical issues evoked by these instruments and institutions. I question several established ways in which the agency of MNEs has traditionally been perceived in IPE and related disciplines and suggest new pathways for more ambitious research on MNEs and their governance. Moreover, I challenge the methodological nationalism that still prevails in many contributions published within IPE, as well as simplistic level-of-analysis schemas that rely on Westphalian concepts of sovereignty and rigid distinctions between local, state and international levels.

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Helsinki, 5 January 2018, at the cafeteria of Hakaniemi Leikkiluola playground

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# LIST OF ORIGINAL PUBLICATIONS

This thesis is based on the following publications:

- I            Ylönen, M. (2016). Back from Oblivion? The Rise and Fall of the Early Initiatives against Corporate Tax Avoidance from the 1960s to the 1980s, *Transnational Corporations Journal* 23(3): 33–65.
- II           Finér, L. & Ylönen, M. (2017) Tax-Driven Wealth Chains: A Multiple Case Study of Tax Avoidance in the Finnish Mining Sector, *Critical Perspectives on Accounting* 48(2017): 53–81.
- III          Eskelinen, T. & Ylönen, M. (2017). Panama and the WTO: New Constitutionalism of Trade Policy and Global Tax Governance, *Review of International Political Economy* 24(4): 629–656.
- IV          Ylönen, M. & Teivainen, T. (2017). Politics of Intra-Firm Trade: Corporate Price Planning and the Double Role of the Arm's Length Principle, *New Political Economy*, in press.
- V           Ylönen, M. (2017). Policy diffusion within international organizations: A bottom-up analysis of International Monetary Fund tax work in Panama, Seychelles, and the Netherlands, UNU-WIDER Working Paper 157/2017, 2017.
- VI          Ylönen, M. (2016). Cities as World-Political Actors? The “Tax Haven-Free” Cities Initiative and the Politics of Public Procurement, *Palgrave Communications* 2, Article number: 16041 (2016).



# ABBREVIATIONS

ALP	Arm's Length Principle
AML	Anti-Money Laundering
APA	Advance Pricing Agreement
BEA	United States Bureau of Economic Analysis
BEPS	Base Erosion and Profit Shifting
CCV	Committee on Customs Valuations
CESO	Centro de Estudios Sociales
CFC	Controlled Foreign Company
CIT	Corporate Income Tax
CoC	Code of Conduct
CSR	Corporate Social Responsibility
DISC	Domestic International Sales Corporation
DPC	Development Policy Committee (of IMF and World Bank)
DSB	Dispute Settlement Board
EC	European Commission
ECLA	Economic Commission on Latin America
ECOSOC	Economic and Social Council (of United Nations)
EP	European Parliament
EU	European Union
FATF	Financial Action Task Force
FDI	Foreign Direct Investment
FTA	Free Trade Agreement
GAAR	General Anti-Avoidance Rule
GATS	General Agreement in Trade on Services
GATT	General Agreement on Tariffs and Trade
GEISAR	Group of Experts on International Standards of Accounting and Reporting
GEP	Group of Eminent Persons
GPE	Global Political Economy
GSP	Generalized System of Preferences
GWC	Global Wealth Chain
IASB	International Accounting Standards Board
IASC	International Accounting Standards Committee
IB	International Business studies
IEO	Independent Evaluation Office (of IMF)
IMF	International Monetary Fund
IMFC	International Monetary and Financial Committee (of IMF)
IO	International Organization
IPE	International Political Economy
IPR	Intellectual Property Rights
IR	International Relations

LoI	Letter of Intent
MNE	Multinational Enterprise
NGO	Non-Governmental Organization
NIEO	New International Economic Order
OECD	Organisation for Economic Cooperation and Development
OEP	Open Economy Politics
TCCV	Technical Committee on Customs Valuations
TIEA	Tax Information Exchange Agreement
TNC	Transnational Corporation
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
UNCTC	United Nations Centre on Transnational Corporations
VAT	Value Added Tax
WTO	World Trade Organisation



# 1 INTRODUCTION

Corporate tax avoidance has become a much-discussed topic within social sciences, as well as in policy circles and public debates. In November 2017, a staggering 13.4 million files from several offshore financial service providers were released by the International Consortium of Investigative Journalism, highlighting in particular the role of the leading offshore law firm Appleby in international tax avoidance and evasion. The leak generated numerous front-page news stories involving tax evasion and other illicit practices by high-level politicians and businesspersons all over the world. The scale of the leak was unprecedented, but it was hardly the first of its kind. Recent years have seen a number of information leaks from tax havens, most notably the Panama Papers incident, which focused on the Panamanian offshore service company Mossack Fonseca, and the LuxLeaks case, which involved secret tax rulings issued by Luxembourg and tailored by the tax advisory company PwC. PwC is one of the so-called ‘Big 4’ advisory companies that all have roots in the auditing business but derive a significant percentage of their profits from tax-planning consultancy.

Moreover, various investigations by non-governmental organizations (NGOs: e.g. Hearson & Brooks, 2010), in the media (Bergin, 2012) and in academia (Finér & Ylönen, 2017; Ylönen & Laine, 2015) have illustrated how corporations and wealthy individuals can avoid taxes and other obligations to states where their production, sales efforts and other real business activities take place. While there is a body of accounting and economics literature on the magnitude and drivers of tax avoidance, global tax governance only started to emerge as a serious research topic in studies of global governance approximately 10 years ago (Dietsch & Rixen, 2016, p. 1). As an illustrative example, in 2011, Thomas Rixen stated that the causes of tax competition “have received no attention” in the scholarship of International Political Economy (IPE) (Rixen, 2011, p. 3). This situation has slowly started to change, even though most of the existing research has focused on the features of the world political economy that enable tax avoidance and evasion (such as tax havens), rather than Multinational Enterprises (MNEs) themselves. This dissertation is part of this effort.

A great number of studies have been written on the societal impacts of MNEs with regard to labor and environmental issues. In addition, corporate social responsibility has become a major research topic in business studies and other disciplines. However, scholars have paid far less attention to the various ways in which tax avoidance opportunities shape the political role of MNEs in the global political economy.<sup>1</sup> In line with Yuri Biondi and other critical legal

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<sup>1</sup> In recent years, several scholars of international business have started to focus on so-called “political corporate social responsibility”. However, the foundational texts in this line of studies

scholars (Avi-Yonah & Sivan, 2007; Biondi, Canziani, & Kirat, 2009; Robé, 2011), I explore how MNEs can exploit their dual nature as a network of national accounting entities with a centralized mode of operation. This creates a better understanding of the relationship between markets and politics in contemporary world politics, including the ways in which the economic decisions of MNEs can shape the political-economic structures where they operate. In other words, the focus of my dissertation is on offshore finance in general and the societal power it grants to large MNEs in particular.

This introductory article serves four partly interrelated purposes. First, I review how the research agenda on the political aspects of MNEs was shaped by the historical development of IPE. Second, I discuss how corporate tax avoidance emerged as a research concern, first in the 1970s as part of the broader interest in corporate power and later in the 1990s in studies of offshore finance. Third, I argue that early IPE research drew on much larger bodies of research than textbooks and historical accounts typically acknowledge: IPE was not just a marriage of international relations and international economics, but rather a pastiche of various disciplines ranging from accounting to international tax law and international business research. However, the discipline eventually lost part of this diversity, which has been detrimental to our understanding of the societal and political aspects of corporate tax avoidance. I argue that the IPE project began to recover from this blow only in the late 1990s and that, in one sense, this process is still underway. Fourth, this dissertation is also future-oriented, and I conclude by discussing some pathways for building a more comprehensive agenda for tax and corporate research within IPE studies. In other words, in addition to aiming for understanding, I also have an emancipatory cognitive interest in pursuing these goals (Habermas, 1971, p. 198). In line with Robert Cox, this could be conceived of as a way of reflective theorizing, which can “open up the possibility of choosing a different valid perspective from which the problematic becomes one of creating an alternative world” (Cox, 1981, p. 128).

While I mostly refer to IPE for the sake of clarity and for historical reasons, the articles in this dissertation fall under the umbrella of Global Political Economy (GPE). Typically, researchers who adopted broader approaches to trans-border political economic questions have preferred the label global political economy, whereas scholars who saw the IPE project as a sub-field of International Relations (IR) often preferred the prefix “international” (Palan, 2013). In the words of Palan (*ibid.*), one way to distinguish GPE is that it should perhaps be considered “not as a bounded but as a ‘frontiered’ discipline; an outer-, rather than inner-oriented field of study; its attention is directed towards an outlying area where it overlaps with other ‘disciplines’.”

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have typically omitted to discuss what they mean by politics, associating it with the service provision of MNEs, especially in fragile states (see e.g. Crane, Matten, & Moon, 2008; Matten & Moon, 2008).

Much of the power that corporations exert in world politics derives from their ability to exploit the offshore infrastructure of tax havens and other jurisdictions that are in a gatekeeper role in the offshore infrastructure. MNEs, for example, have a wide range of opportunities to artificially shift profits to their preferred jurisdictions. In order to analyze these issues, it is helpful to understand how the key terms related to corporate tax evasion and offshore finance are commonly defined. Corporate tax avoidance aims at avoiding taxes due in one or more countries. It is often contrasted with tax evasion, which is illegal, while tax avoidance is not. Corporate tax avoidance benefits from the offshore infrastructure (Christensen, 2011) of tax havens, whose history dates back to the early 1900s (Palan, 2003). In 1981, the U.S. Treasury published its landmark Gordon Report, which noted that there was no single, clear, objective criterion for labeling a country as a tax haven. The report offered a range of potential definitions instead (Gordon, 1981). The one common characteristic was opacity: “by definition, all of the jurisdictions with which we are concerned afford some level of secrecy or confidentiality to persons transacting business, particularly with banks” (Gordon, 1981, p. 15).

From today’s viewpoint, the most influential definition was introduced in 1998 by the Organisation for Economic Cooperation and Development (OECD), defining a tax haven as a country with no or only nominal taxes on relevant income; a lack of effective exchange of information between tax authorities; a lack of transparency in the operation of the legislative, legal or administrative provisions; and no substantial business activities (OECD, 1998, p. 23).<sup>2</sup> Finally, some commentators have stressed the central role of secrecy in the business models of tax havens (in contrast to merely low tax rates), arguing that “secrecy jurisdiction” would be a better term to capture the nature of these activities (Beard, 1985). The Financial Secrecy Index of the Tax Justice Network adopts this approach by weighing several secrecy-related criteria against the weight that a particular jurisdiction has in the world economy.

One occasionally overlooked division runs between corporate tax havens and investor tax havens. Although many jurisdictions are popular with both groups of clients, this is not always the case. As a rule of thumb, illegal tax evasion commonly associated with smaller-scale investment activities needs secrecy in order to conceal the real beneficiaries and the nature of the transactions. Multinational enterprises that engage in aggressive tax avoidance often benefit from secrecy legislation as well, but not all tax avoidance structures are associated with a high level of secrecy. To give just one example, a large tax treaty network and a tax law that boasts various exemptions have enabled the Netherlands to become one of the most important corporate tax havens, even though they provide relatively extensive public financial accounts of many of the holding corporations registered there.

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<sup>2</sup> Some scholars have preferred “offshore financial centers” either as a synonym for tax havens or as a subset of countries.

Base erosion and profit shifting (BEPS) have recently become commonly used terms. The OECD defines BEPS as “tax avoidance strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations.” In effect, the term covers a wide range of mechanisms that MNEs use to avoid taxes. According to a very conservative estimate by the OECD, tax losses arising from BEPS are between 4 and 10% of corporate income tax revenues globally. In monetary terms, this would amount to tax losses of between 100 and 240 million USD, in 2014 dollars (OECD, 2015b, p. 15). Mirroring the great majority of the statistical research on corporate tax avoidance, this estimate is based on the commercial Orbis financial account database. Its data has several deficiencies, most of which contribute to an underrepresentation of the real scale of the phenomenon (Finér & Ylönen, 2017). Most importantly, the Orbis database draws on national public financial accounts databases, even though many key tax havens do not publish these financial statements. The majority of statistical studies (including the one by the OECD mentioned above) also focus on differences in nominal corporate tax rates. However, much of international tax avoidance benefits from special tax exemptions, with nominal tax rates only playing a secondary role.

Large corporations are often referred to as multinational companies, transnational corporations or variants of these terms (Wilkins, 2001, p. 5). In this article, I use the term MNE to describe large corporations that operate in more than one country. One rationale for this is that some cross-border enterprises can also operate in legal forms other than corporations and an MNE is always composed of many companies registered in several countries. However, the term “transnational corporation” also has merit. This term places more emphasis on the transnational nature of the MNEs’ business models. Hence, the term ‘transnational corporation’ is also used in some of the articles that comprise this dissertation. Finally, one crucial question for understanding MNEs’ potential to exert societal or political power is how to define politics, markets and the market mechanism. I discuss these questions in the following section and also in one of the articles of this dissertation (see Ylönen & Teivainen, 2017).

The structure of this article is as follows. In the following section, I discuss some of the key meta-theoretical standpoints behind this dissertation, especially in the context of critical theory. This is followed by Section 2, in which I consider how the societal and political power of MNEs has been discussed in different social scientific and business disciplines from the early 1900s onward. Drawing on various theoretical backgrounds, this section demonstrates how corporate power started to emerge as a viable research topic in the early 1900s. This section also considers the development and growth of International Business scholarship from the 1960s onward. However, as I argue in one of the subsequent articles (see Ylönen, 2016), many of these and subsequent strands of research had lost much of their appeal by the 1970s.

After this groundwork, Section 3 discusses the other strands of research that eventually gave rise to IPE. Of particular relevance are certain Marxist and

developmentalist scholars, whose work I discuss in a dedicated sub-section. Section 3 also traces the evolution of IPE to its current form. In particular, I discuss the question of why the early IPE scholars did not continue pursuing themes related to corporate power. This theme only resurfaced in the 1990s and these contemporary theories of offshore finance and its relevance for corporate power are the topic of Section 4. Moreover, Section 4 also includes a discussion on how the articles of this dissertation contribute to existing scholarship. I conclude in Section 5 with a future-oriented discussion on some of the emerging trends in research and policy fields.

## **1.1 META-THEORETICAL STANDPOINTS**

Broadly speaking, this dissertation falls under the umbrella of World Politics, which is typically understood as a sibling of IR. A body of literature has been written on the differences between world politics and international relations (e.g. Walker, 1993, 2010). For the purposes of this study, suffice it to say that most of the traditional strands in IR studies have largely centered on the traditional state system, whereas the past few decades have seen a significant increase in the variety of actors in the international system. In the words of Albert, “world politics is not something that emerges from pre-existing levels of (local, national etc.) politics, nor is it located somehow ‘above’ them. The system of world politics is differentiated as a subsystem within the political system, so questions of hierarchy between ‘levels’ do not play a large role in this respect” (Albert, 2016, pp. 6–7).

Many of the issues I highlight are also relevant for understanding the demarcation line between political economy and mainstream neoclassical economics. Particularly after the marginalist revolution of the early 1900s, neoclassical economics has relied extensively on the assumption of perfect competition, at least as an analytical tool (Hodgson, 2001; Milonakis & Fine, 2009). Consequently, the neoclassical framework treats monopolies, oligopolies and other glitches in the market system as exceptions, which brushes aside questions related to corporate power (Tsuk, 2005). According to the two first welfare theorems of neoclassical economics, no transaction costs exist because market participants have perfect information about markets. Each market participant is a price taker (i.e. pays the market price for their purchases) and no monopolies exist. As economist Franklin M. Fisher has argued, these “well understood and firmly founded” theorems “underlie all the looser statements about the desirability of a free-market system” (Fisher, 2002, p. 74). Fisher’s colleague Kirman (2002, p. 470) concurs with him by stating that “the Fundamental Theorems of Welfare Economics are the cornerstones for the arguments in favour of economic liberalism.” Therefore, as Susan Harding has contended, it can be argued that in some respects,



neoclassical economics “defends and legitimates the institutions and practices through which the distortions and their often exploitative consequences are generated” by certifying “as value-neutral, normal, natural, and therefore not political at all the policies and practices through which powerful groups can gain the information and explanations that they need to advance their priorities” (Harding, 1998, p. 132).

In practice, however, entire sub-fields have emerged within neoclassical economics to study “anomalies” and different variations of disequilibrium (Fisher, 2002). During the first decades of the 1900s, mainstream economic theory had major difficulties with integrating multinational enterprises into the general framework. The major dilemma was that if markets are supposed to operate under market conditions where prices are determined efficiently within markets, corporations should not exist. After all, internalizing transactions that would otherwise take place through the market mechanism essentially requires superseding markets. Multinational enterprises are, after all, hierarchically organized systems. Drawing on Coase’s research (Coase, 1937), transaction cost theory made a real breakthrough as the most important analytical tool to overcome this in the 1970s. Transaction cost theory is thus one sub-field with particular relevance to this dissertation.

Spearheaded by contributions from Olivier Williamson (1971) and others (see Section 4), transaction cost theory associated the benefits of internalization with transactional market imperfections in situations where there are long time lags between initiation and completion of the production process. In other words, it considers situations in which “the efficient exploitation of market power over an intermediate product requires discriminatory pricing of a kind difficult or impossible to implement in an external market” (Ietto-Gillies, 2014, p. 44). Other instances include situations “when imperfections would lead to bilateral concentration of market power and thus to an unstable situation under external markets” or “when there is inequality in the position of the buyer and seller regarding knowledge on the value, nature and quality of the product” (Ietto-Gillies, 2014, p. 44).

I will return to the subject of transaction cost theory in more detail later in this section when discussing the emergence of International Business scholarship. Related to this, I argue that the growing societal role of MNEs in the global political economy cannot be reduced to transaction cost theory or a similar framework. Rather, a better understanding of the politics of corporate tax avoidance and corporate power is needed. As I highlight in the article co-written with Teivo Teivainen, the U.S. courts had to admit as early as the 1960s that in many cases, the intra-firm trade within MNEs *does not* follow any market-based prices. As a result, the courts advocated the use of different variations of cost-plus pricing for tax purposes in cases where market-based prices cannot be found. This flexibility in choosing the pricing model when determining the taxable income in different group companies was also subsequently reflected in the OECD’s influential transfer pricing guidelines. While the prevalence of cost-plus pricing is consistent with the empirical

material on how intra-firm trade operates, it is largely ignored in the economics-oriented theories of the firm. An exception to this can be found in post-Keynesian economics, which is based on a notion that firms aim to achieve market power and that their pricing models typically rely on cost-plus formulas instead of straightforwardly reflecting the forces of supply and demand (Lavoie, 2007, 2014). As I argue with Teivainen in the aforementioned article, the non-market nature of much of this intra-firm trade opens up possibilities of theorizing MNEs as political agents.

Although the “linguistic turn”<sup>3</sup> largely benefited social sciences from the 1960s and 1970s onward (Giddens, 1984, pp. xv–xx), it also resulted in a situation where the attention given to discourses, deconstructions and linguistics diverted many researchers in political science away from the relationship between economic and political power. It can be argued that these developments contributed to the increasing segregation of studies on corporate power from neoclassical economics. Giddens (1984, p. xxxii) may not have perceived the irony when he wrote “if the social sciences are understood as they were during the period of dominance of the [earlier] orthodox consensus” that placed emphasis on the search for unbiased knowledge of society, “their attainments do not look impressive, and the relevance of social research to practical issues seems fairly slight.” In the subsequent decades, however, positivistic economic theories gained the upper hand over social scientists with their increasing emphasis on studying narratives and linguistic practices.

Indeed, part of the relevance of transaction cost theory and other abstract assumptions in much of neoclassical theory derives from their role in constituting the social order in which they are applied. In other words, these assumptions are “reflections upon a social reality which they also help to constitute and which both has a distance from, yet remains part of, our social world that engages our attention” (Giddens, 1984, p. xxxv). Any attempt to genuinely reform these theories would require identifying and deconstructing unrealistic assumptions behind them in order to build a more plausible framework for analysis. This would also require questioning some categorizations of international relations that still enjoy wide popularity also within the IR field itself. As R.B.J. Walker has noted, much of the traditional analysis of international relations stems from the “level of analysis schema” of “man, states and international system” that has received too little critical appraisal (Walker 1993, p. 131). Even though Walker made this statement more than two decades ago, it still contains a significant truth. By adopting a broader focus than IR, World Politics expands this ontology by giving more weight to the diversity of actors than states in shaping the international realm.

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<sup>3</sup> The linguistic turn typically refers to a development whereby scholars started to pay more attention to the relationship between philosophy and language. In social sciences, it led to greater attention being paid to discourses in the construction of social order.

Drawing on evolutionary economics, critical legal scholarship and other approaches, the key question I pose here is how should the world-political role of corporations be understood? An interesting departure point for this is the work of Roberto Mangabeira Unger, who has defined politics as a “struggle over material and passionate relationships over resources and arrangements of our everyday lives” (Unger, 1987, p. 145). This differs from the widely used conception of politics by Chantal Mouffe, who has defined it as an “ensemble of practices, discourses and institutions which seek to establish a certain order and organize human coexistence in conditions that are always potentially conflictual because they are affected by the dimension of ‘the political’.” The political in turn is characterized by a “dimension of antagonism that is inherent in human relations” (Mouffe, 1999, p. 15). Compared to Mouffe’s account, Unger’s conception directs the attention more to the material issues rather than to searching for “antagonisms” in society. However, by taking into account our “passionate relations”, Unger avoids defining politics in entirely materialist terms.

Giddens (1984, pp. xxxi–xxxii) introduced the concept of “transformation points” that “translate” private property and a cluster of ownership rights into industrial authority or modes of sustaining managerial control. I maintain that the strict separation of states and markets is a key element sustaining this transformation and preventing its opening up to competing claims of authority. Specifically, understanding corporations as potentially political actors could expose them to demands that are normally valid only in the democratic sphere. In this sense, my dissertation includes a normative aspect. By raising new questions on the nature of corporate power, this project could also be seen as emancipatory (Sayer, 2000, p. 18) or liberating (Manicas, 1987, p. 321). Unger’s conception of politics allows us to transcend strict and somewhat artificial state-market divisions (Teivainen, 2002). Specifically, I focus on corporate tax avoidance mechanisms to demonstrate how not only states, but also companies can engage in struggles over material relationships. For example, a major mining company in a small developing country might have a large influence over that state’s ability to decide on material relationships through normal democratic processes.

I also draw on the tradition of critical realism, which emerged initially from a rigorous critique of positivism in the natural sciences. In line with positivists, critical realists are “naturalists” in the sense that it is “both possible and desirable to study social phenomena ‘scientifically’” (Potter & López, 2001, p. 8). However, even though there are causal mechanisms at play in our shared world, our understanding of them is always shaped by language. Therefore, we can never obtain completely neutral information about the world. As Sayer (2000, p. 16) has noted, “typically, social scientists are dealing not only with systems that are open but ones in which there are many interacting structures and mechanisms.” “This creates the risk of attributing to one mechanism (and its structure) effects which are actually due to another.” Consequently, there is

a need for a critical theory that “stands apart from the prevailing order of the world and asks how that order came about” (Cox, 1981, p. 129).

In order to move forward from these propositions, we need to consider the factors that construct and reproduce the prevailing conceptions of states, markets and the legitimacy of firms (Sayer, 2000, p. 16). This is in line with Cox’s idea of critical theory that “does not take institutions and social and power relations for granted but calls them into question by concerning itself with their origins and how and whether they might be in the process of changing” (Cox, 1981, p. 129). To give one relevant example, it is important to analyze the concepts we use when talking about corporations. Are we taking them for granted as market-based entities or is it possible to find instances where the language of politics leads to more appropriate results? In the words of Manicas (1987, p. 318), “social structure is ‘product’ in the sense that speaking reproduces the language, going to work reproduces the system of capitalism, and voting reproduces electoral politics.”

My contribution has a strong historical dimension. Much has been written on the political aspects of the corporation since 1904, when Thorstein Veblen first published his iconoclastic book *The Theory of Business Enterprise* (1919).<sup>4</sup> However, as important as the works of Veblen, Berle and Means (1934), Galbraith (2010), Baran and Sweezy (1966), and others are, they are products of their time. As a result, historical horizons need to be treated carefully and sensitively to avoid misunderstandings of what history actually shows (Gadamer, 1989, p. 270). As insightful as many of the classics are, it would be a mistake to invariably apply their concepts in the analyses of contemporary uses of corporate power. Therefore, a proper understanding of corporate power today requires an analysis of both its historical roots and its contemporary manifestations. This is also in line with the mindset of critical realism in the sense that “social science is *inevitably* historical. History is not merely ‘the past’, but *a sedimented past which, as transformed, is still present*” (Manicas, 1987, p. 320, emphasis in the original).

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<sup>4</sup> Veblen and other early evolutionary economists also drew on the earlier work of Richard Ely and others, but their predecessors lacked the consistency and comprehensiveness that characterized Veblen’s analyses.

## 2 THE EARLY HISTORY OF RESEARCH ON CORPORATE POWER

Studies of the political and societal power of corporations have a long and scattered history. For more than a century, evolutionary economists, Marxists, legal scholars and other researchers have discussed the impacts of MNEs and their non-market impacts on the states and societies in which they operate. The founder of evolutionary economics, Thorsten Veblen, analyzed these issues in depth as early as 1904 in his aforementioned book *The Theory of Business Enterprise*. Even though most of the analyses written by Veblen (1919, 1923), John R. Commons (1934, 1957), Gardiner Means (1959, 1962), Adolf Berle (1947), Robert Hale (1935, 1952), and others were either relatively abstract or focused mostly on the United States, later IPE studies could have benefited in many ways from adopting some of the concepts and ideas developed by these scholars. To highlight one significant example of this, John Kenneth Galbraith — one of the greatest theoreticians of the societal power of the corporation — was in many ways influenced by earlier evolutionary economists, such as Adolf Berle and Gardiner Means (Galbraith, 1988; Parker, 2005).

Veblen wrote his first major work, *The Theory of the Leisure Class*, in 1899 and his last, *Absentee Ownership and Business Enterprise in Recent Times: The Case of America*, in 1923. These were among the most important and exciting decades in the development of the modern corporation, and Veblen was the first scholar to capture many of the significant changes that were taking place at the time. The key undercurrent which Veblen analyzed in his books *Absentee Ownership* (1923) and *The Theory of Business Enterprise* (1919) was the separation of business and industry, which until then had constituted a single field. According to Veblen, it was this transformation of ownership that resulted in the transformation of corporate control.

One of Veblen's theses was that absentee ownership and control were killing the competitive system "at the top," as "free competitive production had ceased to be the rule in the key industries." Veblen argued that this "decay" had "been spreading outwards and downwards" as lower branches of the industry had been "brought into line with the mechanical technology" (Veblen, 1923, pp. 77–78). These developments also eroded the function of the entrepreneur as it had been understood in the original, competitive conceptions of capitalism. It "gradually fell apart in a two-fold division of labor, between the business manager and the office work on the one side and the technician and industrial work on the other side" (Veblen, 1923, p. 106). Veblen showed how the "modern machine process" gave way to greater specialization within industries, led to the standardization of processes, machinery and labor regulations, and ultimately standardized all of social existence, from work to consumption and leisure (Bowman, 1996, p. 111;

Veblen, 1919). Veblen's analyses of corporate power, diverging interests within large corporations and so on laid the foundation for much of the subsequent social scientific research on corporations and management.

Adolf Berle and Gardiner Means developed some of Veblen's ideas in their iconoclastic book *The Modern Corporation and Private Property*. Sometimes even hailed as the bible of the New Deal (Means, 1964, p. 27), the book provided a more nuanced analysis of the effects of absentee ownership and the separation of stock owners and managers in the modern corporation. One of the key concepts of Berle and Means was "administered prices," which refers to the phenomenon in which the market mechanism became subdued within the managerial machineries of large corporations. In the preface to the revised edition, Berle and Means noted that the book was published at a time when the central body of economic theory "held that so long as there was competition among producers economic performance would be high" (Berle & Means, 1934, p. xxxiv).

In the early 1930s, the world of corporations was in flux, and Berle and Means gave shape to ideas that had thus far existed only in embryonic form. Spearheading the concept of administered prices, the authors called for a research agenda that would overcome the assumption of classical economic theory that prices were automatically right (Means, 1962, p. 10). This resonated well with people at a time when the non-market aspects of large corporations were under increasing critical scrutiny and Berle and Means made great advances in further developing the theory of the modern corporation. The task before them was significant. As late as 1954, Berle noted in the new introduction to his *20<sup>th</sup> Century Capitalist Revolution* that "no adequate study of twentieth-century capitalism exists" and that "scholarly commentators are quite aware that the descriptive clichés still in current use are little more than a deposit of verbiage left over from a previous historical age" (Berle, 1954, p. 9).

Berle and Means used extensive sets of statistical data on the concentration of American industries to develop their theoretical thesis on the separation of ownership and control in the large corporations (Berle & Means, 1934).<sup>5</sup> Moreover, they noted that even though "men still living can recall a time when the present situation was hardly dreamed of ... the new order may easily become completely dominant during the lifetime of our children." When the authors were writing their book, the factory system had first "brought an increasingly large number of workers directly under a single management," followed by the emergence of the modern corporation that "equally revolutionary in its effect, placed the wealth of innumerable individuals under the same central control" (Berle & Means, 1934, p. 5). As a result of this, the profit motive had become distorted (Berle & Means, 1934, p. 307). These were

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<sup>5</sup> In addition to their great impact on American institutional scholarship, Berle and Means influenced other strands of thought, such as the Frankfurt School (see for example Marcuse, 2006).

bold statements, but later developments have proved that they were largely correct (Ware, 1992). Even in Berle and Means' time, large corporations had become a prominent feature of U.S. capitalism. Their ownership was continually becoming more dispersed and the power that was formerly divided between a large number of owners had become increasingly concentrated. Together, these developments separated corporate control from ownership, thus establishing the corporate system (Berle & Means, 1934, pp. 9–10).

The administered prices framework provided useful tools for analyzing a situation that could neither be portrayed as pure market competition nor as a monopoly as these concepts are usually understood (Means, 1962, p. 12). In a U.S. Senate hearing on administrative prices, Means (1957, p. 75) defined an administered price as “a price set by someone, usually a producer or seller, and kept constant for a period of time and for a series of transactions.” The opposite of an administered price is a market price “that fluctuates on the basis of supply and demand as these forces are felt in the market” (1957, p. 75). All established definitions of markets are based on prices that fluctuate on the basis of supply and demand. Means made an important point that in the modern economy, such freely fluctuating market prices are often nowhere to be found. Most prices are set for weeks or months at a time, as companies set target prices and plan their actions in the longer term (1957, p. 75; 1962, p. 239). While Means argued that this phenomenon existed even in Adam Smith's time, back then it was a minor issue and hence did not receive attention in classical economic theory (1957, p. 76). In contrast to this, today's corporations have no choice but to plan their pricing for the longer term, even if they end up adjusting their prices at regular intervals based on demand, the prices charged by their competitors or other factors. This view is also supported by later accounting literature (Shim & Sudit, 1995).

Of course, not all prices are administered. The major exception that Means mentions are the prices quoted in centralized marketplaces, such as those for wheat or cotton. Any major company needs to plan its production, sales and marketing efforts with models that essentially violate the textbook definitions of markets (Ylönen & Teivainen, 2017). Even today, a case can be made that “market forces will limit the range within which an administered price is likely to be set but they do not determine the price” (Means, 1957, p. 76).

From the viewpoint of economic theory, a significant issue is that “wherever a price can be administered, there is almost certain to be a zone of relative indifference within which various prices would produce practically the same profit.” This zone of relative indifference does not depend on size or having a monopoly (Means, 1957, p. 82).<sup>6</sup> Indeed, Means found the narrow understanding of monopoly in economics harmful. Specifically, he argued that “where you have administered prices you may have monopoly, you may have

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<sup>6</sup> As a result of this and other challenges, Means believed that “administered prices lie quite outside the realm of traditional economic thinking and present serious problems which cannot find solution within the realm of traditional theory” (1957, p. 89).

what the economists have come to call oligopoly,” adding that he preferred calling this situation “administrative competition,” which is different from classical competition as it takes place using administrative prices (1959, p. 4801). Means argued that, in the long run, the end result of administrative competition might roughly be the same as that of classical competition, but “whether it produces the same effect in the short run is a different matter” (1959, p. 4801).

Berle and Means made progress in analyzing the behavior of administered prices in complex company structures. They noted that “through controlled directors the parent has all of the powers of directors,” and that this enables a parent of a holding corporation to perform all key operations “with respect to its subsidiaries and their assets and earnings” (Berle & Means, 1934, p. 183). Moreover, they noted that holding companies have “a far wider latitude in this respect perhaps than any other corporation.” In holding companies, “control of the parent’s directors over the subsidiaries’ machinery is absolute; even the information disclosed may be so blind as to be unintelligible.” Moreover, “the possibility of inter-company transactions — that is, sale of the assets of one subsidiary to another subsidiary; the routing of profitable business to one subsidiary in preference to another, the concealment of losses or the creation of non-existent deficits, make possible an almost unlimited variation in the resulting income account” (Berle & Means, 1934, p. 183). These were far-sighted notions, given how important holding companies have become for the corporate planning system in subsequent decades.

Both of these two scholars were unsure of the extent to which the powers conferred by the holding company system could actually be exercised. In 1947, Berle saw “the difference between outside creditors as against intra-enterprise or inter-corporate debts” as “striking” (Berle, 1947, p. 356). Today, the extent of these powers is better known and case studies on the use of intra-firm debt to gain artificial benefits have become commonplace. Berle and Means made important remarks on the role of information in intra-firm price administration. Administering prices requires detailed information, but “such information must be considered as a private matter, of interest only to its shareholders; and even in that regard limits in the extreme the information which the corporate management must make available, even to its shareholders” (Berle & Means, 1934, p. 279).

Price administration posed a challenge to the established theories of economics and that it “brought a concentration of economic power which can compete on equal terms with the modern state” (Berle & Means, 1934, p. 313). They believed that this concentration of power leads to what Means called “competitive waste,” which referred to the tendency to provide “a price umbrella” for new entrants, “whether or not costs are also increased through competitive promotion” (Means, 1962, p. 214). Despite this, both Berle and Means were still relatively optimistic about the possibilities of reforming the system of administered prices. Means, for example, believed that administering prices “leads to greater efficiency and higher standards of



living” (1957, p. 75). Moreover, he maintained with Berle that “if the corporate system is to survive ... the ‘control’ of the great corporations should develop into a purely neutral technocracy” (1934, p. 313). These suggestions resonated at a time when “the need for economic planning” was discussed widely and did not carry the same negative undertone as it does today (Plummer, 1971, p. 2).

In 1941, Trotskyist scholar James Burnham published a book titled *Managerial Revolution*, in which he assessed the impact of the modern corporate form on the class struggle and other Marxist themes. Among other things, Burnham was interested in how corporate managers were able to exert power though property rights vested in them as individuals, but also indirectly, “through their control of the state which in turn will own and control the instruments of production.” He then argued that these powers make corporate managers the new ruling class in capitalism. However, for our purposes, Burnham’s most interesting idea was the distinction between managers, finance executives and finance capitalists. Criticizing Veblen for an overtly simplistic division between engineers and managers, Burnham highlighted the role of finance and banks in steering the great corporations. The first division was between managers, who oversaw the details of the production process, and the sales process, which was the responsibility of finance executives.

However, for the purposes of this article, finance capitalists are the most interesting group. Utilizing holding companies, banks and other tools, the emerging group of finance capitalists shaped the financial aspects of all large companies, from mergers to stock and bond issues. “They may want to put some competitors out of business or influence politics or inflate prices; and any of such aims might be altogether independent of the requirements of production or profit,” Burnham argued. “Any number of variants is possible.” Finance capitalists often included directors of the company, and particularly big financiers and bankers who actually appointed the directors. Outside these three groups were the actual owners, given that the ownership in large corporations had become more dispersed, as Berle and Means already noted in the 1930s. However, Burnham criticized Berle and Means for their failure to “include any study of the way in which their supposedly self-perpetuating and autonomous managements are in actuality often controlled by big banks or groups of financiers.”

In his landmark publication *The New Industrial State* (Galbraith, 2010, p. 651), John Kenneth Galbraith put forward a more pessimistic vision of planned prices. Drawing his empirical evidence from the economic landscape of the United States of the late 1960s and addressing growing concerns over the powers of the American “military-industrial complex,” he introduced the framework for corporate planning. Galbraith described corporate planning as a situation in which the market is superseded by vertical integration with the planning unit taking over the source of supply or the outlet. In this context, vertical integration refers to the vertical ownership structures that characterize large corporations. Within this system, transactions that are

subject to bargaining over prices and amounts are thus replaced with transfers within the planning units.

After World War II, ownership in many key U.S. industries became concentrated in the hands of relatively few companies. This situation sparked criticism of Ricardian theories of free trade that were based on the idea of an unobstructed market mechanism. Galbraith argued that, in contrast to orthodox theories of trade, “the great corporation maximizes not pecuniary return but the whole complex of organizational interests of which pecuniary return is only one part” (Galbraith, 2010, pp. 617–618). Other goals gradually overshadow these economic or “pecuniary” interests as the size and the relative importance of a corporation in a particular market grows (Galbraith, 2010, p. 620). In line with Berle and Means, Galbraith saw planning as an inevitable activity for large corporations, as they constantly need to seek a balance between short-term profits, long-term risks and other factors. The “technostructure” of modern corporations “is compelled to put prevention of loss ahead of maximum return. Loss can destroy the technostructure; high revenues accrue to others. If, as will often happen, the maximization of revenues invites increased risk of loss, then the technostructure, as a matter of elementary interest, should forgo it” (Galbraith, 2010, p. 788).

Galbraith wrote his book in the context of a relatively oligopolistic U.S. corporate economy and he mainly focused on corporations’ abilities to plan their prices in order to outbid competitors or to extract greater profits from geographical or business areas where the competition was less fierce. Galbraith’s key insight (2010, p. 733) on the consequences of the increased planning capacity of corporations for the dominant economic approaches is worth citing at length:

“When planning replaces the market, [the] admirably simple explanation of economic behavior collapses. Technology and the companion commitments of capital and time have forced the firm to emancipate itself from the uncertainties of the market. And specialized technology has rendered the market increasingly unreliable. So the firm controls the prices at which it buys materials, components and talent and takes steps to ensure the necessary supply of these prices.”

Galbraith’s writings had a major impact on the intellectual landscape of the 1960s and 1970s. Two other researchers who made major contributions at the time when IPE scholarship began to emerge were Richard Barnet and Ronald Müller, who conducted important research on the role of the corporate planning framework in an international setting. Müller was a professor of economics, while Barnet has been described as “a blend of political scientist, historian, reporter and essayist,” even though his original degree was in legal studies (Holley, 2004). In their 1974 book *Global Reach: The Power of the Multinational Corporations*, Barnet and Müller provided a far-reaching analysis of the ways in which corporations can artificially shift their profits

from one country to another and thus exert power over states. They noted that the “global corporation is the first institution in human history dedicated to centralized planning on a world scale.” While its primary purpose is to “organize and integrate economic activity around the world in such a way as to maximize global profit, the global corporation is an organic structure in which each part is expected to serve the whole” (Barnet & Müller, 1974, p. 14). This has much in common with Galbraith’s ideas and could have provided a fertile point of departure for the GPE project. Another promising development for the GPE project was the investigation conducted in the 1960s by John F. Kennedy’s administration into possibilities of addressing offshore tax avoidance by U.S. multinationals.

However, these ideas did not garner attention from the evolving strand of research within international business studies. The internationalization school evolved during the 1960s and 1970s and led to the birth of the first genuine theory of transnational corporations, as proposed in 1960 by Stephen Hymer in his doctoral dissertation. In his thesis, Hymer essentially created the theory of foreign direct investment (FDI) (Hymer, 1976). As Buckley and Cason (1976) have argued, the orthodox economic theory of the time was “not very helpful” in understanding why firms internationalize and “the theories of imperfect competition which explained the behavior of trusts” needed to be “reformulated and extended before they can be applied to the MNE.” Nevertheless, Hymer’s ideas were not appreciated at the time and MIT Press refused to publish the dissertation (Pitelis, 2006, p. 105).

Prior to Hymer’s work, mainstream economic theory explained FDI primarily as a result of interest rate differences between countries. This did not reflect the reality of international business, given the multitude of factors that firms consider when investing abroad. Using empirical data from various industries, Hymer pointed out that FDI was concentrated in industries across nations rather than in particular nations across industries. He argued that there were two main drivers of a firm’s decision to invest abroad. The first was closer to the prevailing economic understanding of the time, namely “to ensure the safety of his investment” (Hymer, 1976, p. 24). However, Hymer argued that there was another rationale for foreign direct investment: “to remove competition between that foreign enterprise and enterprises in other countries” (1976, p. 25).

Much of the remainder of Hymer’s thesis discussed how large corporations managed to suppress or remove competition. For example, he noted that enterprises in different countries often competed with one another “because they sell in the same market or because some of the firms sell to other firms” and that these situations often encouraged corporations to invest abroad to reduce competition (1976, p. 25). Moreover, major differences in MNEs’ abilities to operate in a particular industry also drove foreign direct investment. In sum, the “motivation for the investment is not the higher interest rate abroad but the profits that are derived from controlling the foreign enterprise” (1976, p. 26). In addition to these factors, Hymer

mentioned diversification as an additional but less important reason for investing abroad (1976, p. 33).

Hymer wrote his thesis in an era of strict limitations on cross-border exports, imports, investments and capital movements. In this regard, his views became outdated as the deregulation of the world economy progressed. Nevertheless, the underlying analysis of the drivers of FDI shared many similarities with the analyses of Barnet and Müller more than a decade later. This is also highlighted in an article Hymer wrote in 1972. Discussing the “multinational corporation and the law of uneven development,” Hymer noted that “a government’s ability to tax multinational corporations is limited by the ability of these corporations to manipulate transfer prices and to move their productive facilities to another country” (1972, p. 128). According to Hymer, underdeveloped countries “will find it difficult to extract a surplus” from multinational corporations, in contrast to developed countries, in which “the home office[s] and financial center[s] of the multinational corporation[s] are located” and which can “tax the profits of the corporation[s] as a whole, as well as the high incomes of [their] management” (Hymer, 1972, p. 128). These aspects of Hymer’s work have not received much attention, and it is fair to say that his results were more far-reaching than many later commentators realized. In viewing FDI in terms of surpassing markets, Hymer cast doubt on the meaningfulness of much of the dominant economic theory.

However, International Business scholars did not continue to develop the discipline along these lines. Hymer’s successors tied the theoretical development of transnational corporation research increasingly to the framework of neoclassical economics and management studies. While these approaches have produced significant quantities of research on how and why corporations transnationalize, the underlying issue of the relationship between markets and planning in the world economy has remained unaddressed. In this sub-section, I review these key studies with a focus on their contributions to understanding the corporate planning system.<sup>7</sup>

Raymond Vernon was working on his international product lifecycle theory at around the same time that Hymer was developing his thesis. Vernon’s theory essentially pictured a process in which companies gradually move production outside of their borders as they grow and the markets in their home countries mature (Vernon, 1966). His work drew heavily on the wide-ranging Multinational Enterprise Project, which Vernon directed at Harvard from 1965 onward. The project employed several researchers and generated a number of books, dissertations and articles. Its outcomes included, for example, two major historical accounts on the internationalization of American companies by Mira Wilkins (1970, 1974). In other words, while Vernon is typically credited as the second major theorist of IB (following

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<sup>7</sup> I do not aim to provide a comprehensive review of corporate transnationalization theses. These types of accounts already exist. See, for example, (Ietto-Gillies, 2005, 2014).

Hymer), his ideas were developed in close collaboration with a broader group of emerging scholars.<sup>8</sup>

Compared to Hymer's dissertation, Vernon's most famous book, *Sovereignty at Bay*, paid more attention to developments in other disciplines, in addition to making a lasting impact on much of the subsequent GPE research. This book portrays an academic landscape in which theories of efficient markets were gaining increasing prominence. On the other hand, many scholars were convinced by Galbraith's theories of an affluent society in which "demands for private goods have to be fabricated by the corporate world through the application of artificial stimuli." Vernon also contended that these same scholars were "reluctant to believe that any substantial measure of competition may exist among the large corporations" (1971b, pp. 114–115). (I believe that this was either an exaggeration or a misunderstanding of Galbraith's ideas). Vernon's own main interest was in the role of products in the transnationalization of corporations. He also noted that economists were not overly interested in his book *Sovereignty at Bay* when it was published in 1978, because most economists "saw research on the multinational enterprise as largely irrelevant to their discipline" (Vernon, 1993, p. 20).

The key elements of Vernon's theory were "innovation in products which gives the firm a temporary monopolistic position [and the] interaction between the life of the product, the degree of competition in the industry and the geography of trade and of FDI/production" (Ietto-Gillies, 2014, p. 43). Whereas Hymer focused on the ways in which corporations strove for monopoly power, Vernon acknowledged that there are also more subtle ways of bypassing markets. Specifically, he noted that "multinational enterprises... transfer goods and services among affiliates at prices that are often at variance with the results that independent buyers and sellers would reach." However, in contrast to Barnet and Müller, he stated that "the cases so far uncovered do not create the basis for assuming that there is a systematic bias in favor of assigning the largest profit to the parent" (Vernon, 1971b, p. 139).

Vernon updated his ideas on corporate power nearly three decades later in his book *In the Hurricane's Eye*, but he did not radically alter his core thesis. Instead, he stated that the 1970s were "a period of great pain for the multinationals," singling out Barnet and Müller's *Global Reach* as "a much-publicized attack," complemented by U.S. Senate investigations into the role of U.S. enterprises in the Middle East and Latin America. In contrast, Vernon saw the 1980s and 1990s as a period of "redemption for the multinational enterprise," because MNEs were being widely acknowledged as the principal bearers of technology across international borders and widely sought after for their capital resources and managerial skills (Vernon, 1998, p. 5). Moreover,

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<sup>8</sup> Wilkins published pioneering work on historical structures from the early 1970s onward, in addition to commenting on the ideas of economic historians, such as Alfred D. Chandler Jr., Albert O. Hirschman and Charles P. Kindleberger, as well as those of Hymer, Dunning, Servan-Schreiber and Vernon (Wilkins, 1974, pp. xi–xii).

In the Hurricane's Eye included a more sophisticated analysis of the various tax-planning techniques that companies have at their disposal, but this was still more of a sidestep than a new theoretical opening (1998, pp. 207–211). In her review of the history of the theory of the MNE, Ietto-Gillies has also noted that later technological developments brought shorter product lives and changed the sequences of locations involved in international production, thus undermining the explanatory potential of Vernon's theory (2014, p. 43). Finally, and perhaps most crucially for the purposes of this dissertation, the shift of focus from enterprises to products left the active political agency of firms undertheorized.

Vernon's books have since become part of the canon of transnationalization literature, even when mainstream IB scholars began to utilize more mathematical methodologies than those used by Vernon. The same cannot be said for the works of Vernon's two above-mentioned adversaries, Richard Barnet and Ronald Müller, whose ideas were rejected in the IB community early on. In hindsight, this was unfortunate because their book (*Global Reach*) Corporations was essentially the first major work to comprehensively discuss corporate planning in the context of transnational corporations (however, see also Galbraith, 1973). In a sense, Barnet and Müller adopted many of the key ideas that had been developed earlier in evolutionary economics and applied them to international situations. However, the earlier scholars on this continuum were not ignorant of the opportunities presented by internationalization. Berle (1954, p. 118), for one, noted that "most corporations shroud their international arrangements in deepest secrecy," also discussing the anti-competitive power of international cartels in Europe and elsewhere. However, Berle focused mainly on the role of large corporations in foreign relations and did not pay attention to intra-firm planning power, which was an emerging issue when Berle wrote these words.

When Barnet and Müller eventually published *Global Reach*, the situation had changed markedly. Speaking invariably about transnational corporations, planetary enterprises and global corporations, Barnet and Müller (1974, p. 14) maintained that their rise "is producing an organizational revolution as profound in its implications for modern man as the Industrial Revolution and the rise of the nation-state itself" (1974, p. 15). Presaging the later rise of commercialized sovereignty and other related concepts, they also maintained that the extraordinary powers of transnational corporations arose from their capabilities "to transform the world political economy and in so doing transform the historic role of the nation-state" (1974, p. 15).

Barnet and Müller made significant and overlooked contributions to the analyses of intra-firm price planning. Essentially, their book can be perceived as a proverbial bridge between the early research on corporate planning and contemporary political economy analyses on corporate tax planning. Noting the importance of "esoteric techniques" made possible by tax havens such as Liechtenstein, the Bahamas, the Cayman Islands, Panama and Luxembourg, Barnet and Müller argued that the "simple expedient of selling to one's own

wholly owned subsidiary at an absurdly high price where local taxes are high or at a bargain where taxes are low can do wonders for global profit maximization—which is, after all, the prime goal of corporate planning and the ultimate test of its success or failure” (Barnet & Müller, 1974, p. 37). As a result, “when the corporate headquarters is acting as both buyer and seller, the very concept of the market has lost its significance” (1974, p. 157). This may have sounded like a bold claim, but Barnet and Müller linked it to a rather impressive and mature analysis of the various techniques that global corporations use to plan their prices. Many of these methods are at least as relevant today as they were in 1974.

One interesting concept proposed by Barnet and Müller was cross-subsidization. When the corporate planning system becomes global, they argued, “the parent company can shift profits through transfer pricing, ‘profit-loan swaps’ and other accounting miracles on a worldwide scale, cross-subsidizing its various operations with the profits of others.” This was an important conceptual opening that went mostly unnoticed by their contemporaries and present-day researchers working in this area. Its importance lay especially in the realization that, if faced with non-market phenomena, relying on market-based terms in analyzing them can often divert attention to the wrong questions. There were many similarities in the thinking of Barnet, Müller and Galbraith. In line with Galbraith’s *The New Industrial State*, Barnet and Müller noted that “the key element in determining the relative bargaining power of foreign corporations and political leaders in poor countries is knowledge” (1974, p. 193). In an important passage (1974, p. 214), they argued that the world was witnessing:

“... a new concentration of political power in what are, in legal and political terms, private hands. [...] The principal source of their power is their control of knowledge of three specific kinds: the technology of production and organization—i.e., how to make, package, and transport; the technology of obtaining and managing finance capital—i.e., how to create their own private global economy insulated from the vicissitudes of national economies by means of shifting profits and avoiding taxes; the technology of marketing—i.e., how to create and satisfy a demand for their goods by diffusing a consumption ideology.”

While this analysis focused largely on vertically integrated corporations of the 1970s, it touched upon several important developments in the global political economy that reached their full bloom only in the decades following the publication of *Global Reach*. Importantly, Barnet and Müller saw that states are not only disadvantaged because of disparities in technical expertise. Rather, the global corporate planning system distorts entire statistical and accounting systems that are supposed to help states to regulate corporations. Specifically, the intensification of global corporate planning turns corporate balance sheets into “less and less accurate reflections of real economic activity”

(1974, p. 256). As a consequence, “skilled obfuscation” becomes an essential accounting tool (1974, p. 263) and the government loses “the relatively little power it has had to regulate with reasonable effectiveness because it does not know what it is regulating” (1974, p. 261).

Barnet and Müller also touched upon the relationship between global corporate planning systems and economic theory. Noting that “under traditional capitalist theory, private greed was supposed to lead to public good because of the character of the market,” the authors stated that this assumption did not hold true in the emerging global corporate planning framework. “The global corporation, essentially because it does most of its trading with itself, has delivered the coup de grâce to the market” (Barnet & Müller, 1974, p. 229). They maintained that “the power accumulated by giant oligopolies by the late 1950s to control supplies, set prices, and create demand had made an anachronism of the classic concept of the market even before Big Business became global,” but it was corporate-driven “globalization” that “completed the process” (1974, p. 229). Finally, one of the important points raised in *Global Reach* was that “large corporations plan centrally and act globally, and nation-states do not.” In contrast to most accounts of economic globalization, the merit of this approach was that it allowed for a meaningful analysis of how states had lost some of their powers and what types of societal powers large corporations had consequently gained.

*Global Reach* was a product of its time and its authors could not have predicted the major transformations of global capitalism that would occur in the decades following its publication. For example, Barnet and Müller maintained that the global corporation was “transforming the world political economy through its increasing control over three fundamental resources of life: the technology of production, finance capital, and marketing.” In the current millennium, this analysis has become somewhat outdated with the increasing overall financialization of economies, the growing importance of global value chains in MNEs’ operational models, and so on. Despite its far-sighted analyses, Barnet and Müller’s book failed to make a lasting impact and there are several possible reasons for this. First, like many classics of evolutionary economics, *Global Reach* was sparingly referenced, despite the obvious intellectual debts the book owed to Galbraith, Means, Berle and others. Moreover, it neither mentioned nor discussed the United Nations policy initiatives intended to address corporate planning (Ylönen, 2016). Lastly, the work was written in an occasionally provocative and controversial style.

Ultimately, Barnet and Müller’s contributions were largely forgotten. Within IPE scholarship, this relative absence of reflection on earlier works and ongoing research downplayed the importance of political aspects of corporate planning. There was also a lack of textbooks that could have focused on this



particular theme.<sup>9</sup> The scholarly community pointed out certain factual errors in Barnet and Müller's book that were thought to erode its argument generally (Bowman, 1996). Of course, many canonical books have contained errors, but if history has proved their main thesis correct, these lapses have commonly been overlooked. Related to the previous point, Barnet and Müller's thesis on why and how enterprises transnationalize differed markedly from mainstream analyses in the nascent body of literature in this field at the time, which was focused on mapping the determinants of foreign direct investment. This became evident in the polemic exchange between Barnet and Müller and Vernon in *Foreign Policy*, following an issue in which the three had each elaborated on their views on transnational corporations in separate articles (Vernon, Barnet, & Müller, 1974). Specifically, Vernon saw Barnet's article as "an advocate's brief" directed at least partly against his own views. In response, Vernon accused Barnet and Müller of neglecting evidence that would have supported a more positive view of transnational corporations' role in developing countries. As an example of this bias, he correctly pointed out the difficulties that corporations face in determining market prices.

In his response to Vernon's claims, Barnet criticized Vernon for focusing on a single case (exports from Columbia) and using it to conclude (unconvincingly, in Barnet's view) that Barnet and Müller's analysis was not based on sound data. Müller's rejoinder followed similar lines. Vernon seemed to have the final word in this heated exchange by repeating his earlier critique that Barnet and Müller had bypassed contrary evidence and important qualifications when reporting their results. I believe that the tone and focus of this and other similar debates hampered the development of the theory of the tax planning aspects of the multinational enterprise. Any normative conclusions or framings that Barnet and Müller proposed in their book should not have negated its contributions to understanding the global corporate planning framework. After all, Vernon himself did not deny the existence of the phenomena that Barnet and Müller described; rather, he doubted whether Barnet and Müller had correctly estimated the scale of corporate planning, and he criticized them for neglecting the positive results that direct investments brought to developing countries.

The absence of genuine dialogue between the theorists of corporate planning and researchers focusing on determinants of FDI was in many ways unfortunate. Whereas Hymer, Vernon and other pioneers of IB research conducted important studies on the patterns and drivers of FDI, they did not pay sufficient attention to the question of "whether exports benefit a poor economy depends critically on the price" and other similar issues that had relevance to the balance of power in the world economy (Barnet & Müller,

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<sup>9</sup> One attempt to address this issue was the body of training and textbook material that the United Nations Centre on Transnational Corporations produced in the 1970s. However, these documents are little known and less utilized today, and they have even been removed from the UN website's archives (Ylönen, 2016).

1974, p. 37). This was a major theme among dependency theorists and Marxist scholars, whose work I discuss later. The mainstream IB scholarship paid too little attention to global companies buying from and selling to their own subsidiaries with “prices that often have little connection to the market price” (Barnet & Müller, 1974, p. 157).

Broadly speaking, there are currently two mainstream theoretical strands that aim to explain why corporations internationalize. The first is internalization theory, which is based on the transaction cost approach. The second is John Dunning’s theory, which centers on ownership, locational and internationalization (OLI) advantages. Both orientations aim to explain international production as an extension to the theory of the firm (Dunning, 1979, p. 274). Consequently, the evolution of these theoretical frameworks has led International Business research to become increasingly closely aligned with mainstream economic research (Dunning, 1979, p. 274). One of the key books was by Buckley and Casson (1976) and some further key contributions include Teece (1977) and Rugman (2006). Acting as a background to these efforts were Coase’s analyses of the importance of transaction costs in understanding corporations (1937), which Williamson helped bring to the wider readership (1975, 1981).

In their important book *The Future of the Multinational Enterprise*, Buckley and Casson extended the Coasian framework and asserted that their new internationalization framework could include the contributions of Hymer and Vernon as special cases. In the words of the authors, “it is little exaggeration to say that at present there is no established theory of the multinational enterprise,” because previous studies allegedly lacked “a comprehensive theoretical basis” (Buckley & Casson, 1976, p. 32). Specifically, the authors maintained that the two key assumptions of orthodox economic theory were profit maximization and perfect competition. According to them, previous theories of the MNE had attempted to replace this orthodoxy either by allowing for the pursuit of alternative managerial goals or by relaxing the expectation of perfect competition “to allow for the exercise of monopoly or oligopoly power” (Buckley & Casson, 1976, p. 32). In their framework, Buckley and Casson embraced the latter condition more heartily than the former, while also providing an array of motives that can prompt MNEs to internalize production. These motives are the creation of internal futures markets given significant time lags in interdependent activities, imposing a discriminatory pricing system, avoiding costs related to bilateral bargaining, eliminating buyer uncertainty, and “the ability to minimize the impact of government interventions through transfer pricing” (Buckley & Casson, 1976, p. 44). In the words of Casson (Casson, 1979, p. 84), this “minimisation of tax and tariff payments redistributes income from the public to the private sector.” In other words, Buckley and Casson acknowledged the importance of intra-firm tax planning, even though they discussed it in different terms than some of their contemporaries.

One particular flavor of the internalization perspective is that of Rugman, who aptly noted in his book that was originally published in 1981 (2006) that the “need for an internal market always remains in the valuation of information, and transfer prices for this intermediate product are justified,” even though “so-called arm’s length prices do not exist” (2006, p. 65). Therefore, MNEs create their own internal “markets” out of necessity. Such an internal market “becomes an integral part of the firm,” making it difficult to distinguish the “firm’s organizational structure from its internal pricing” (2006, p. 22).<sup>10</sup> Both this statement and Rugman’s were at least somewhat far-sighted when they were written, and it is striking that neither Rugman’s nor Buckley and Casson’s frameworks have generated much research on the tax-motivated use of transfer pricing in international business studies. One reason for this may be that Rugman very clearly excluded tax-driven transfer pricing from his analysis by stating that “the internal pricing of knowledge advantages by the MNE is merely a response to the lack of a market. It is not a suspicious action but a rational one by an efficient business organization, the MNE” (2006, p. 65). He also argued that “multinationals have a relatively restricted scope for transfer price manipulation” and that the MNE “should be allowed to use whatever transfer prices it cares to” (2006, p. 67). In other words, Rugman’s version of the internalization framework deliberately excluded concerns related to the harmful effects of intra-company transfer pricing. Curiously, no data were introduced to back up this claim.

John Dunning built his renowned framework around OLI advantages. Dunning pursued a diverse career, acting, for example, as an advisor for several of the UNCTAD’s World Investment Reports, in addition to participating actively in the UNCTC’s work. He paid respect not only to the work of Veblen but also to that of Commons, noting the latter scholar’s role in forcibly taking “the neoclassical economists to task for neglecting non-market transactions” (Dunning, Cantwell, & Corley, 1987, p. 33). In Dunning’s framework, ownership advantages are specific to a particular enterprise, constituting competitive advantages over rivals and enabling the company to take advantage of investment opportunities wherever they arise. This set of advantages links Dunning’s theory to Hymer’s. Locational advantages are those advantages specific to a country, which are likely to make it attractive for foreign investors. Internalization advantages are those benefits that derive from producing internally. They allow the firm to bypass external markets and the transaction costs associated with them. They are, essentially, benefits of operating within hierarchies rather than markets. This set of advantages links Dunning’s theory to internalization theory and to Coase’s theory of the firm.

In some of his earlier key texts, Dunning (1977, 1979) argued that “the market mechanism may be replaced by administrative fiat for six possible

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<sup>10</sup> However, Rugman speaks somewhat confusingly about intra-firm “markets” when describing more-or-less hierarchical transactions that often do not reflect any market prices (Ylönen & Teivainen, 2017).

reasons” (Dunning, 1979, p. 277), namely to reduce transaction and negotiation costs; to exploit asymmetric knowledge; to control the supply of inputs, product, or production strategies and access to markets; to exploit advantages of size; to protect property rights; and to exploit or protect oneself against government interventions. Regarding the last point, Dunning noted (1977, p. 405) that “how far MNEs actually do manipulate intragroup prices to transfer income across national boundaries is still a matter of empirical research.”

As can be seen from the above, Hymer, Vernon, Dunning and other first-generation International Business scholars engaged with historical data employed a variety of different methods and engaged in scholarly debates across disciplinary borders. Jones and Khanna note that Vernon “produced a cohort of graduate students” whose work drew on economic history, including John Stopford, Larry Franko and Lou Wells (Jones & Khanna, 2006, p. 454). While their work did not discuss corporate planning power or related issues as such, they did engage with ideas advocated by scholars and popular non-fiction authors who discussed corporate power, such as Jean-Jacques Servan-Schreiber (Franko, 1974; Stopford, 1974) and others.

Corporate power was also discussed by early American business historians. Even though corporate power was not a central focus of the early studies of these historians, they did contribute important insights to this topic. To highlight one example, in his 1959 article “The Beginnings of ‘Big Business’ in American Industry,” Alfred Chandler discusses the “bureaucratization” of large companies and, more generally, the oligopolistic tendencies in the U.S. economy of the time. With the emergence of vertically integrated, centralized and departmentalized industrial organizations, “costs, rather than interfirm competition, began to determine prices” (Chandler, 1959, p. 28).

However, as IB studies matured, most of this methodological and disciplinary diversity was lost. According to Jones and Khanna (2006, p. 454), a growing pressure emerged “for a standardized social science methodology, especially multiple regressions,” which became the *de facto* standard for articles published in the *Journal of International Business Studies* and other prominent IB journals. As part of this development, qualitative research came to be seen as “non-rigorous” and the “general pressure for quantification did not encourage deeper engagement with the often patchy or partial data available historically” (Jones & Khanna, 2006, pp. 454–455). Qualitative studies were often published in book format and “their sheer size and approach make access to non-specialists difficult, especially as many IB scholars — along with other management scholars — were increasingly disinclined to read book-length studies” (Jones & Khanna, 2006, p. 455). Crossing disciplinary boundaries became as hard “in this field as elsewhere” (Jones & Khanna, 2006, p. 455; see also Toyne & Nigh, 1997a). Today, the IB literature “is remarkable for its absence of discourse on such central questions as: What is IB? What kinds of phenomena are appropriately termed IB phenomena? How do IB activities and relationships differ from non-IB

activities?” (Toyne & Nigh, 1997b, p. 27). As Jones and Khanna put it (2006, p. 453):

“International business scholars know that 'history matters', AIB meetings have had a 'business history' track, or else included business history as a subcategory in a thematic track, since 1998. A simple search showed that the word 'history' was mentioned in articles and notes – or at least one-third the total – published in JIBS since 1990. Yet not a single article was either explicitly devoted to the history of IB, or employed historical data to explore an issue.”

The consequences of this diminishing disciplinary interaction went beyond methodological issues. One particular area of research that suffered from the evolution of IB scholarship was the political economy of developing countries. Whereas the United Nations Centre on Transnational Corporations (UNCTC) and researchers associated with it emphasized the importance of regulating large MNEs, in the late 1970s, development-oriented IB researchers started to pay increasing attention to the emerging research agenda in economics around the concept of rent seeking (Stein, 2008). One exception to this general decline was Constantine Vaitsos, who produced particularly farsighted analyses on the impacts of MNEs in developing countries in the mid-1970s. In contrast to some other critical scholars, his works were also read by many mainstream researchers in the evolving IB research community (Droucopoulos, 1976). In his book *Intracountry Income Distribution and Transnational Enterprises*, Vaitsos researched non-market practices in five industries, namely chemicals, pharmaceuticals, rubber, textiles and electronics.

Showing the strategies firms use to siphon profits from developing countries in order to maintain and strengthen their market positions, Vaitsos argued that initial technological monopolies are frequently transformed into institutional ones because of the unequal relationship between MNEs and their host states. This gives MNEs the upper hand in both the negotiation of licensing and other agreements, and their internal pricing. In Vaitsos's words, the concentration in the supply of FDI and the market structures has led to a situation where sector-oligopoly situations are much more representative than market-based frameworks (Vaitsos, 1974, p. 28). Other factors that contributed to these situations were the “size of firms undertaking foreign direct investments, their acquisition and merger processes” and “their managerial and other performance” (Vaitsos, 1974, p. 28). As a consequence, “viewed in this light the product cycle theory is seen as a theory of monopoly cycles” (Vaitsos, 1974, p. 18, emphasis in the original).

One reason that Vaitsos managed to incorporate so many fresh ideas into his framework may have been related to his research material and methodologies. In particular, he used a variety of novel methods to obtain information on the actual prices MNEs used in their intra-firm trade, ranging from customs data to industry publications. This body of data was

complemented by in-depth analyses of individual financial accounts, various licensing contracts and the minutes of governmental committee meetings (Vaitsos, 1974, pp. 31–41). However, this kind of approach has never been a commonly used framework in IB studies, and Vaitsos's book failed to make a lasting impact in either IB studies or development research. In fact, financial accounts research has only very recently emerged as a promising tool for critical corporate research (Finér & Ylönen, 2017).

In contrast, two particularly important scholars who were successful in steering the development-related debate into the more conventional international business mainstream were Anne Krueger (1974) and Jagdish Bhagwati (1982). Much of their work focused on developing mathematical hypotheses regarding the impacts of the rent-seeking behavior of politicians and civil servants. Building on ideas originally developed by Tullock (1967) and others (for a review, see Tollison, 1982), Krueger argued that in an ideal world “with no restrictions, entrepreneurs would seek to achieve windfall gains by adopting new technology, anticipating market shifts correctly.” However, this is hampered by a non-functioning market system characterized by competitive rent seeking between politicians and civil servants. As the ideas spread, a consensus emerged in IB research “that business groups, often controlled by families, existed to rent-seek, and therefore did not serve any socially useful purpose” (Jones & Khanna, 2006, p. 455).

As demonstrated by the above review, the early theorists of the corporation and transnationalization theory — namely, Hymer, Galbraith, and Barnett and Müller — shared striking similarities in their analyses of corporate power. They were also undoubtedly helped by the even earlier work on the corporation conducted by Thorsten Veblen, John R. Commons, Adolf Berle, and Gardiner Means. This body of research could have formed the basis for an evolving research agenda on corporate power, taking into account its interactions with offshore finance and overall financialization tendencies. However, in the 1970s and early 1980s, theoretical developments took a different path. In conjunction with broader developments, which saw many countries revise their policies toward MNEs either voluntarily or under pressure from the World Bank and the International Monetary Fund (IMF), the discussion on monopoly power and other strands that addressed the non-market power of MNEs lost much of their appeal. Consequently, the empirical debates on the scale and magnitude of non-market corporate planning were gradually consigned to oblivion. Moreover, when similar concerns about corporate tax avoidance and other related phenomena began to emerge in the late 1990s, many of the earlier participants in these debates were no longer there to revitalize and reform their earlier analyses.

### 3 THE BIRTH OF THE IPE

International political economy was born in the early 1970s in a situation characterized by the disentanglement of the Bretton Woods monetary system, the growing internationalization of large businesses, steady growth in world trade, and increasing concerns about corporate misconduct in developing countries (Cohen, 2008). In just a few years, several international relations (IR) scholars and economists began publishing books and articles highlighting the importance of developments in the international economy as one determinant of an international political system. These efforts partly overlapped with similar developments in other disciplines, such as Marxist studies and development economics (see previous section), as well as economic history (see also Cohen, 2008, p. 21; Keohane, 2009).

While many of these developmentalist and Marxist scholars were also well known in IR circles, their ideas did not garner much attention in IR scholarship prior to the emergence of the IPE. Towards the end of the 1970s, IPE studies began to emerge in greater numbers and since then, IPE research has progressed rapidly (Denemark & O'Brien, 1997, p. 214). I will show how during the formative years of the IPE, there was constant interaction and exchange of ideas between scholars of IPE, International Business and other disciplines, as well as with policy-makers within the United Nations organizations. However, as the IPE matured, many of these connections were lost. I will firstly discuss each of the strands of research that influenced this emerging IPE scholarship and then focus on the emergence of IPE.

#### 3.1 INFLUENCES OF MARXISTS, DEPENDENCY THEORISTS AND WORLD-SYSTEM SCHOLARS

Early Marxist research on corporate power centered on the concept of imperialism, most notably articulated in Lenin's 1917 book *Imperialism, the Highest Stage of Capitalism* (1965), but also in the works by Hilferding (1981), Luxemburg and Bukharin in the first decades of the 20th century (Palma, 1978, p. 889). The term "imperialism" was first applied to the relationship between "backward" and "advanced" countries within the capitalist system and later to the totality of the monopolistic phase of capitalism (Palma, 1978, p. 884). Lenin's *Imperialism* contained many themes that were discussed by the evolutionary economists of the time and that later recurred in other disciplines. For example, commenting on cartelization tendencies, Lenin quoted the German scholar Vogelstein, who had stated that "while at that time it appeared to be something novel, now the general public takes it for granted

that large spheres of economic life have been, as a general rule, removed from the realm of free competition” (Lenin, 1965, p. 20).

Moreover, Lenin argued that the “holding [company] system,” to which I have already referred in Section 2, “should be made the cornerstone” of understanding the new stage of capitalism, given that it enabled capitalists to gain a controlling interest in more companies with less capital than ever before (1965, p. 54). Citing the example of an off-balance-sheet loan from a German steel company to its subsidiary, Lenin maintained that “the ‘holding system’ not only serves enormously to increase the power of the monopolists; it also enables them to resort with impunity to all sorts of shady and dirty tricks to cheat the public, for the directors of the ‘mother company’ are not legally responsible for the ‘daughter company,’ which is supposed to be ‘independent,’ and through the medium of which they can ‘pull off’ anything” (1965, p. 55, emphasis in the original). Quoting a text by Eschwege from 1914, Lenin maintained that “this typical example of balance-sheet jugglery, quite common in joint-stock companies, explains why their Boards of Directors are willing with a far lighter heart to undertake risky transactions than individual businessmen” (Lenin, 1965, p. 56, emphasis in the original).

Lenin was greatly influenced by Rudolf Hilferding’s book *The Finance Capital* and by many bourgeois economists who studied monopolization tendencies at the time. Marxist scholars also influenced Thorsten Veblen, even though he was not a Marxist himself (Sweezy, 1986, p. 31). The two most prominent scholars in Marxist studies were Paul A. Baran and Paul Sweezy, whose book *The Monopoly Capital* was later deemed “the leading attempt to bring Marx’s *Capital* up to date” (Foster, 2014). Baran and Sweezy saw that much of the “stagnation of Marxian social science” was caused by the fact that “the Marxian analysis of capitalism still rests in the final analysis on the assumption of a competitive economy” (1966), notwithstanding the contributions of Lenin and Hilferding. *Monopoly Capital* was thus essentially an attempt to explain the “strong tendency toward secular stagnation under advanced capitalism” (Foster, 2014), which was driven by increasing monopolization in many industries, both nationally and internationally. This, Baran and Sweezy argued, had led to a situation in which the “tendency of the surplus to rise” had replaced the traditional Marxist law of the tendency of profit rates to fall — an idea that Kalecki also discussed in his work.

Baran and Sweezy’s core thesis was that large MNEs were “turning most modern industries into a variant of the neoclassical model of monopoly.” Hymer had essentially reached a very similar conclusion from a different direction. Given that the most heated scholarly debates are often fought between scholars and groups who disagree more on details than on broader outlines of research topics, it is no wonder that in the 1962 introduction to his *Political Economy of Growth*, Baran admonished Galbraith and other “liberal critics” by saying that “nothing is further from their minds (or at least their public utterances) than ‘touching deeply’ the giant corporation. What can be expected from their recommending various regulatory boards and even their



possible appointment to Distinguished Citizens Committees?” (Baran, 1973, p. xiv).

Another key Marxist theoretician of the corporation, Hugo Radice, called Vernon and Dunning “apologetics” of large corporations (Radice, 1975). What is more, in a chapter that was originally omitted from *Monopoly Capital* because of the death of Paul Baran in 1964, the authors distanced themselves from Galbraith and Berle. In particular, Baran and Sweezy criticized these scholars for advocating the concept of “workable competition” and “a pragmatic, piecemeal approach to problems of monopoly and Big Business”, and for confining “themselves to more or less realistic proposals” for improving the system (Baran & Sweezy, 2012).

Baran was a trailblazer in this field, given that some of his ideas preceded those of Hymer. Comparing the changes seen in the 1900s to the transition from feudalism to competitive capitalism, Baran (1973, pp. 60–61) noted that “the transition from competitive to monopolistic capitalism has resulted likewise in a tremendous increase of the absolute volume of the economic surplus and in the shift of the control over it from the relatively small capitalist to a few giant corporations.” With the growth and propagation of large-scale enterprises, monopolies and oligopolies greatly influenced the distribution of the economic surplus and “the resulting concentration of assets and profits in the hands of a small group of giant concerns (and a small circle of the capitalists who control them) assumes... major significance when we consider our remaining ‘classical’ conditions for growth” (Baran, 1973, p. 61). Baran criticized mainstream economists for firing at monopolies with ammunition “drawn from the arsenal of the theory of perfect competition — the perfect ideology of petty business.” As a result, “the evil effects of large-scale enterprise were seen primarily in the distortion of ‘optimal’ arrangements that were expected to emerge from the reign of free markets” (Baran, 1973, p. 63).

Keynesian economists also came in for criticism from Baran because “the relation between the process of investment (and economic development) and the growing role of large-scale enterprise and monopoly... received only spotty and sporadic attention” from them (1973, pp. 63–64). Specifically, since Keynesian economists treated the bulk of investment as an exogenously determined “autonomous” factor, with little attention paid to its composition, Baran accused their theory of income and employment of bypassing “the problem of the impact of monopoly and oligopoly on the volume and the long-run effect of investment” (1973, p. 64). Galbraith also addressed this in his work. However, Galbraith’s ideas were difficult to systematize into the Keynesian framework and, perhaps for this reason, they have had little impact on its later development.

Significantly, Baran anticipated some of the early ideas of Hymer’s internationalization thesis. Baran maintained that in monopolistic capitalism, oligopolistic and monopolistic firms that operate under conditions of rapidly decreasing costs are even more anxious than their competitive predecessors to expand their sales abroad. Even if the prices in foreign markets are lower than

those at home, companies may find it profitable to push their exports and engage in price discrimination, because discriminatory price reductions will not affect their positions in domestic markets (1973, p. 111). Writing some 35 years before the outbreak of the Latin American debt crisis, Baran also drew attention to large MNEs' opportunities to encourage their host governments to open up new business opportunities abroad via either military or economic means. A loan granted to a company investing in a country with a tight market situation by an "oligopolist government may be tied to conditions that decisively shift the competitive balance in favor of that oligopolistic firm" (Baran, 1973, p. 114).

Some scholars later accused Baran and Sweezy of basing their analysis on the neoclassical conception of "imperfect competition" and overstating the empirical evidence regarding monopolization (Foster, 2014). However, the main Marxist criticism of the Baran–Sweezy thesis, specifically the notion that "oligopolistic pricing can lead to an increasing share of gross profits to income," came from scholars associated with the "internationalization of capital" school (Pitelis, 2000), as suggested by Jenkins (1987) and in a book edited by Radice (1975). In their view, Baran and Sweezy relied too heavily on the neoclassical "quantity theory of competition" model, which regards "competition and monopoly as polar opposite types of market structure" (Pitelis, 2000, p. 202). However, the scholars associated with the internationalization of capital school argued that "competition should be viewed as a process which dialectically links competition and monopoly, as Marx had proposed. Accordingly, increasing concentration need not imply monopoly power, given actual and potential competition by rival firms" (Pitelis, 2000, p. 202).

The Marxist body of theory on large enterprises developed in close interaction with dependency theorists, who were concerned with the factors restraining much of the southern hemisphere from enjoying the benefits of economic progress and integration into the world economy. Gabriel Palma has argued that we can broadly divide development theorists into three major approaches. The first approach built on the writings of Paul Baran, centered on Andre Gunder Frank and continued with the CESO School (Centro de Estudios Sociales of the University of Chile), particularly Brazilian Marxist economist Theotônio dos Santos. This school was characterized by an attempt to construct "a theory of Latin American underdevelopment" (Palma, 1978, p. 898). To highlight one significant example of how this school approached the power of MNEs, in 1970 Dos Santos noted how the postwar period saw the development of a new kind of dependence, one "based on multinational corporations which began to invest in industries geared to the internal market of underdeveloped countries" (Dos Santos, 1970, p. 232). He labeled this dependency technological-industrial dependence because he saw industrial development as being strongly conditioned by the technological monopoly secured and maintained by imperialist powers.

The second approach built on work conducted by the Economic Commission on Latin America (ECLA), which the United Nations established in 1948 as one of its regional commissions. This approach became known for its analyses of Latin American development “from the perspective of a critique of the obstacles to ‘national development’” (Palma, 1978, p. 898). In an illustrative example of this strand, Chilean development economist Osvaldo Sunkel criticized many of the conventional accounts in development economics for analyzing “the national economy in isolation, treated as if it existed in an international vacuum” (1972, p. 519). Specifically, Sunkel noted how dependency theorists had only recently begun to notice how their vast resources had enabled MNEs to “plan the development of consumption” and how these “institutional developments in the United States are reflected abroad as the new multinational corporations spread throughout the international economy” (Sunkel, 1972, p. 521). These MNEs’ activities follow an established pattern, starting with exporting finished products; proceeding to establish sales organizations abroad; continuing by allowing foreign producers to use licenses and patents to manufacture products locally; and finally, buying out the local producer and establishing a partially or wholly owned subsidiary. Through this process, a new structure of international economic relations emerges, one “where trade between national firm Z of country A and national firm Y of country B is replaced by the internal transfers of firm Z to countries A and B, while firm Y vanishes from the picture” (1972, p. 521).

The third approach identified by Palma focuses on an attempt to develop “a mechanic-formal theory of dependency — and to a lesser extent, a mechanic-formal theory of Latin American underdevelopment based on its dependent character — by focusing on ‘concrete situations of dependency’” (Palma, 1978, p. 898). In addition to the orientations highlighted by Palma, one further strand of studies that drew partly from the work of Andre Gunder Frank and his successors was the world-system theory, championed by Immanuel Wallerstein and his colleagues, especially Terence K. Hopkins (Wallerstein, 1974). According to Hopkins and Wallerstein, the world economy should be analyzed as a system experiencing an “ever-present division of centers and hinterlands, or as we shall say ‘cores’ and ‘peripheries’” (Hopkins & Wallerstein, 1977, p. 112), with various countries having distinct roles in global production chains.

The ultimate beneficiaries of these chains are, Hopkins and Wallerstein argued, transnational corporations and their rich host countries. Many scholars built on these ideas, providing detailed analyses of the core-periphery relationships and imperial structures that hindered Southern countries’ attempts to follow the developmental paths that rich northern countries had taken. Even though Wallerstein and Hopkins discussed corporate power only as part of their wider framework for the world economy, their work laid the foundations for the later emergence of bodies of literature on global value chains and, very recently, the framework of global wealth chains (see Section

5.1). These frameworks have also been influential in providing direction for IPE research on corporate power.

One remarkable scholar whose work drew on evolutionary economics, internationalization theories and dependency theories was Gunnar Myrdal, who is better known for his analyses of social policies and Keynesian economics. However, in some of his lesser-known works, Myrdal developed his ideas about combining the corporate planning framework with development viewpoints. Myrdal argued that underdevelopment was not an isolated phenomenon. For him, it was a part of a world process in which powerful nations have impoverishing effects on other parts of the world. Myrdal described these debilitating upshots of world economic relations as “backwash effects.” He pointed out that in the absence of counteracting measures, trade will not move toward an equalization of world incomes. Rather, it strengthens rich and progressive countries, whose manufacturing industries have taken the lead and fortified themselves against the surrounding economies. At the same time, underdeveloped countries are in constant danger of seeing even what they have in terms of industry, particularly small-scale industry and handicrafts, priced out by cheap imports from industrialized countries (Long, 1981, p. 24).

In a little-known section in Myrdal’s book *Economic Theory and Underdeveloped Regions* (1964, p. 49), he notes how in highly integrated states, all prices are essentially manipulated. They “are not the outcome only of the forces in the market; they are in a sense ‘political prices’, depending also on the regulating activity of the state, of quasi-public and private organizations and of private businesses.” Therefore, a “pure” price system is nowhere to be found, because it is shaped by the legislation and administration of the state. In this regard, the prices “correspond to the valuations and objectives which emerge from the democratic political process” (1964, p. 49). Unfortunately, Myrdal did not develop his ideas on “political prices” any further.

The 1980s saw a decline in Marxist and dependency scholarship on the power of MNEs (Lall, 1993, p. 122), but there were some exceptions. In particular, the work conducted by Cowling and Sugden — jointly and separately — deserves to be mentioned. In his 1982 book *Monopoly Capitalism* (Cowling, 1982), Cowling discussed several of the key ideas introduced by Baran and Sweezy and other Marxist scholars. Drawing partly on Keynesian economist Kalecki, Cowling attempted to give a more rigorous form to the concept of monopoly capital, connecting it to broader Marxist and Keynesian ideas. In his opinion, “no attempt [had] been made to provide an exhaustive treatment of monopoly capitalism” (Cowling, 1982, p. 3). However, for the purposes of this project, *Transnational Monopoly Capitalism*, which Cowling published five years later with Sugden, is of greater interest (Cowling & Sugden, 1987). Citing mainly earlier Marxist and Keynesian research, Cowling and Sugden argued (1987, p. 2) that the growth of dominant transnational corporations “leads to monopolisation tendencies within such a system, which in turn imply a potential for a rising profit share, but the consequences of this

for the level of aggregate expenditure will imply a secular stagnation tendency.”

Mirroring (but not directly referring to) some of the ideas put forward by Galbraith, Barnett and Müller, and Vaitos, Cowling and Sugden challenged the Coasian view of the corporation, which was based on a strict division between market and non-market transactions. Reflecting some of the ideas I discuss in subsequent articles, Cowling and Sugden called for a move “away from an obsession with market versus non-market exchange” in order “to explore the very nature of exchanges” (1987, p. 10). In order to overcome these distinctions, which did not truly apply to the everyday realities inside MNEs, Cowling and Sugden called for more attention to the literature on decision-making structures within MNEs, highlighting especially a framework developed by Zeitlin (1974). Cowling and Sugden argued that in MNEs, “control implies the ability to determine broad corporate objectives despite resistance from others,” or, in other words, decisions about strategic issues, such as “a firm’s relationship with its rivals, nation-states and workers, its rate and direction of capital accumulation, its sources of raw materials, and its geographical orientation” (Cowling & Sugden, 1987, pp. 11–12). These strategic decisions are fundamental because, ultimately, they determine the direction of an MNE.

Cowling and Sugden went on to define an MNE as “the means of coordinating production from one centre of strategic decision-making when this coordination takes a firm across national boundaries” (1987, p. 12). Usually, firms transnationalize “either to consolidate or to improve their retaliatory power — i.e. to defend against or to try to attack rivals” (1987, p. 47). Cowling and Sugden point out that their definition covers Coasian firms that internalize market transactions under central coordination, as well as, for example, a clothing production firm that subcontracts part of the assemblage to “housewives looking for additional money” (1987, p. 13). This would fall within Cowling and Sugden’s definition of an MNE, but not within the Coasian definition. It is fair to say that after the 1980s, Marxist and developmentalist debates on international monopoly capital and corporate planning have been few and far between, even though some articles have been published on these themes (Foster & McChesney, 2009; Foster, McChesney, & Jonna, 2011). Below, I argue that this demise of critical thinking on the corporation also fostered the withering of these ideas as part of the IPE/GPE agenda.

### **3.2 THE EVOLUTION OF IPE: FROM A DIVERSE AND EVOLVING FIELD TO OPEN ECONOMY POLITICS**

The dominant realist school of IR had focused on a different set of questions than those posed by development theorists and Marxists who questioned the rigid separation of economics and politics. In the words of Murphy and Tooze (1991b, p. 4), “the IR community first approached the ‘new’ problems of the

world economy in a way that preserved as much of the economics/politics and domestic/international distinctions” as possible. Hence, the dominant research paradigm left little room for any discussions of corporate power. Illustratively, in his iconic neo-realist book *Theory of International Politics*, Kenneth Waltz (Waltz, 1979, p. 94) qualified Charles P. Kindleberger’s then-famous statement that “the nation-state is just about through as an economic unit” by stating that while some states may be “nearly washed up as economic entities,” others are not, and that this “poses no problem for international-political theory since international politics is mostly about inequalities anyway.”

The evolution of IPE research into a distinct school of thought was marked by rivalries and disagreements between the more positivist mainstream tradition and the more social scientifically oriented scholars who emphasized the structural aspects of international capital. The key books and articles from the formative years of IPE demonstrate how the scholars associated with the positivist IPE tradition based their analysis of MNEs largely on the works of the nascent corporate transnationalization school, particularly those of Raymond Vernon, John Dunning and, to a lesser extent, Stephen Hymer. As argued in the previous section, Vernon advocated a relatively optimistic view of the potential of MNEs, with little focus on the potential threats arising from corporate tax avoidance or other forms of corporate power. The influence of Vernon and Dunning extended far beyond academia. Vernon’s *Sovereignty at Bay* became a long-lasting bestseller and both researchers also influenced later research in these areas within the United Nations Conference for Trade and Development (UNCTAD). In contrast, more critical (often European) IPE scholars were typically influenced by the works of a broader group of scholars who often had a more pessimistic view of MNEs. These influences included, for example, French journalist Jean-Jacques Servan-Schreiber (1968), Canadian economist Kari Polanyi-Levitt (2003), and the above-mentioned political economists Richard J. Barnett and Ronald Müller. Eventually, the more social scientifically oriented strands of research faded into the background as product-cycle theory and other major frameworks prevailed.

Attempts to understand the ideological factors affecting the UN-centered New International Economic Order (NIEO) movement played a major role in the birth of IPE (Murphy & Tooze, 1991a, p. 22). One common source of substantial information for both the American and European IPE schools was the body of analysis conducted by UN agencies, such as the UNCTAD and especially the UNCTC and its subgroups. The UNCTC based its analyses on three sources. First, practitioners and experts in accounting, tax law, and beyond prepared much of the important technical content that the UNCTC produced in the 1970s. The second strand of influence came from Raymond Vernon and other scholars of corporate transnationalization. The third distinct group included evolutionary economists such as Barnett and Müller, who owed intellectual debts to a diverse group of scholars, such as Galbraith, Berle and Means.

The scholars of international political economy employed the UNCTC's analyses selectively. Both mainstream and more critical IPE scholars relied on the empirical materials prepared by the UNCTAD and UNCTC, but mainstream scholars rarely referred to the more political proposals and analyses that featured prominently in the critical European IPE tradition. The importance of this distinction became obvious in the 1980s, when the Reagan Administration withdrew much of the UNCTC's funding and effectively blocked its work on a code of conduct for transnational corporations. Critical IPE scholars lost an important source of technical expertise and analysis, while the research agenda for corporate tax avoidance lost much of its steam. This decline was further accelerated by a more general turn toward research on the role of states in critical IPE studies.

When the decline of the UNCTC began, the transnationalization school started to attract growing interest from economists and it developed into a distinct research orientation under International Business studies. The foundations of this school lay in the doctoral thesis of Stephen Hymer, who noticed that the mainstream economic theory of the 1960s offered no plausible explanations for why companies internationalize. In his thesis, Hymer provided the first framework for explaining this phenomenon, followed by many others from the 1960s onward. Even though Hymer's own background was in Marxist studies, the subsequent research typically drew on positivist economics more than on social scientific research traditions. Illustratively, up to this day, no major IB journal has published an article with "tax havens" in its title, despite the mounting evidence of the importance of tax havens in the locational decisions of multinational enterprises (Cobham, Jones, Temouri, & Ylönen, 2017).

The key early accounts that contributed to the birth of the IPE project derived from a wide variety of sources. In the United Kingdom, Susan Strange published her influential article "International Economics and International Relations: A Case of Mutual Neglect" in the 1970s, arguing from her own standpoint within the IR community that the "unequal pace of change in the international political system and in the international economic system, and the effects of this unequal rate of change on the international society, and on the relations of states with one another" had "gone very largely unnoticed" by researchers. In the U.S., Richard Cooper had published *The Economics of Interdependence* two years earlier (1968), and Charles Kindleberger's *Power and Money* was published around the same time as Strange's manifesto (1970).

Benjamin Cohen has noted that Strange's article was published at a time when "both the politics and economics of global affairs were mutating, calling for new understandings of how things work and how they might be studied" (Cohen, 2008, p. 21). Strange provided the first building blocks of an explanatory framework, but in criticizing the realist and state-centric IR theories of the time, paradoxically, she ultimately replicated some of their underlying assumptions. To bridge the apparent gap between politics and

economics, Strange and likeminded researchers called for a research agenda centered on IPE. While no single definition of IPE exists, according to Strange, it concerns “the social, political and economic arrangements affecting the global systems of production, exchange and distribution, and the mix of values reflected therein” (Strange, 1994, p. 18). Strange’s aim to combine international politics and economics omitted accounting, legal sciences and related disciplines that are important for understanding the role that corporations play in world politics.

The power of MNEs did feature prominently in many of these early publications, even though this attention failed to generate a lasting research agenda around corporate power. Kindleberger, for one, devoted a lengthy chapter to issues related to corporate power, including tax avoidance and monopolistic behavior (1970). (Economic historians have been one of the few groups building and maintaining a research orientation focusing on the societal aspects of modern corporations for more than a century.) Furthermore, in an early key IPE textbook, Joan Spero noted that “the special characteristics of multinational corporations have placed them in potential conflict with states, and their international scope has been known to create political problems” (Spero, 1977, p. 90). This international scope is facilitated by a “centralized, integrated organizational structure,” which “reinforces the tendency of multinational corporations to make decisions with concern for the firm and the international environment and not with concern for the particular states in which it is operating” (Spero, 1977, p. 90). However, Spero’s main focus was on how politics shape international economic relations, not the other way around (Gill & Law, 1988, p. xvii).

In another influential early IPE textbook published a year before Spero’s *The Politics of International Economic Relations*, David H. Blake and Robert S. Walters (1976) discussed the role of MNEs in the politics of global economic relations. Noting that “a number of recent developments have focused attention on the multinational corporation as an international actor having important consequences for domestic as well as international politics and economics” (Blake & Walters, 1976, p. 83), Blake and Walters stated that several host-state governments and, particularly, labor officials were “frightened” by “the mobility and flexibility of the corporation, as opposed to the immobility of the state and its work force” (Blake & Walters, 1976, p. 95). Referring to Servan-Schreiber’s best-selling book *The American Challenge*, Blake and Walters (1976, p. 95) stated that “the foreign agent-of-change nature of the enterprise may be considered quite threatening.” Other issues they brought up included the aggressive marketing of products that were not necessary for “the primary tasks involved in modernization and development;” the widening gap between elites and other citizens, who did not enjoy the benefits of the international economy; and so on. However, Blake and Walters also highlighted the benefits of MNEs, such as employment opportunities and tax revenues.



Especially in the United States., much of the early mainstream IPE literature built on the work of Robert O. Keohane and Joseph S. Nye. In their landmark 1977 book *Power and Interdependence* (Keohane & Nye, 2012, p. 31), they stated that “the fact that a particular activity is characterized by nonpolitical behavior — for instance, transactions carried on through a competitive price system — does not imply that political power is unimportant.” For example, “a departure from perfect competition always introduces political factors into the analysis. Once firms can exercise some control over their environments, problems of bargaining, strategy, influence and leadership immediately arise” (ibid., p. 33). However, this was an isolated remark that was not developed much further in the book. This comes as something of a surprise given that in their well-known 1971 editorial “Transnational Relations and World Politics: An Introduction,” Keohane and Nye called for more attention to transnational actors and their connections to the interstate system. Referring, for example, to the work that Raymond Vernon and Stephen Hymer had done on the transnationalization of large enterprises, Keohane and Nye maintained that there was a “control gap” between aspirations for control and the capability of achieving it (Nye & Keohane, 1971, p. 343). This particular special issue of the *International Organization* journal also included a chapter by Raymond Vernon (1971a) based on his famous book *Sovereignty at Bay* (Vernon, 1971b). While Vernon’s article was largely descriptive in its focus on the ongoing trends in the growth of large enterprises, its inclusion in the special issue signified that MNEs were taken seriously in early IPE accounts in the American tradition.

Together with Van Doorn Ooms, Keohane also addressed the issue of “multinational firm and international regulation” in a book titled *Transnational Relations and World Politics*. In one chapter, Keohane and Ooms (1975) distanced themselves from Richard J. Barnet, whom they referred to as an academic “scribbler” (1975, p. 170) because of his normative approach to the regulation of MNEs — and possibly also his fame as the co-founder of the left-leaning think tank Institute for Policy Studies (Holley, 2004). In other words, Keohane and Ooms clearly distanced themselves from the research agenda surrounding corporate tax avoidance that Barnet and Müller so clairvoyantly built in their seminal 1974 book *Global Reach*. At the same time, corporate transnationalization theorists such as Raymond Vernon and John Dunning received positive remarks from Keohane and Ooms. When the evolutionary economic orientation favored by Barnet and Müller began to fall out of fashion and the corporate transnationalization school began to gain steam in the 1980s, it was evident that the latter had the support of mainstream IPE scholarship. Among mainstream American IPE scholars, Robert Gilpin has also acknowledged his intellectual debts to Raymond Vernon’s understanding of the role of large enterprises in IPE, while tellingly noting that Susan Strange did not have “a general impact on US thinking” (*International Relations*, 2005, p. 367).

Academic discussions on corporate power fed into the research agenda of the United Nations Centre on Transnational Corporations (UNCTC), which began operating in 1974. Early IPE scholars followed these discussions closely, and the contributions of the UNCTC were discussed in key IPE textbooks and other canonical texts (Blake & Walters, 1976; Spero, 1977; Strange, 1970, 1998, p. 103). The UNCTC community included a diverse group of scholars and practitioners that had begun to address the areas that Strange identified as gaps in the social scientific scholarship. Early IPE research benefited from the analyses associated with the UNCTC. However, the relationship was largely one-directional. Even though textbooks recognized that MNEs had great power to decide where and how much tax they paid, the key IPE scholars of the time did not have the necessary expertise in accounting and tax law to begin building a research agenda around these issues. Genuine efforts toward trans-disciplinary cooperation between IPE scholars and experts in corporate tax avoidance were few and far between. The research agenda on corporate power thus relied very heavily on input from the UNCTC. The tenuous nature of this situation became evident in the 1980s, when the Reagan Administration cut off resources to the UNCTC, and its project to develop a code of conduct for MNEs came to a halt. The former employees of the UNCTC had to seek employment elsewhere, such as at international consultancy firms.<sup>11</sup> From the viewpoint of the IPE project, this expertise was permanently lost.

Consequently, 20 years after her original manifesto, Strange lamented that very little attention had “been given in the standard literature to the external relations of firms with other hierarchies, whether with other economic enterprises or with political hierarchies like parties, governments, or international organizations” (Strange, 1991, p. 46). However, her own approach was closer to IR studies than any branch of economics — mainstream or not — because it was largely rooted in the framework of states, markets and the international system (Patomäki, 2003). This was evident, for example, in her calls for a “general political study of international loans and debts” and economic warfare (1970, p. 309). Indeed, traditionally, much of the IPE literature related to MNEs has been written in terms of states versus markets. However, this is not a very useful dichotomy, “because the market is a structure, not an actor, and hence a poor counterpoint to the state” (Strange, 1970, p. 309). In fact, a better counterpoint to the state is actually the MNE (Eden, 1993, p. 26).

These biases and omissions persisted as GPE research developed and matured. At some universities, GPE research evolved with a strong positivistic tone, employing primarily quantitative methods and aiming for “scientific” precision — not least because a majority of publications were American and shared this orientation (Gill & Law, 1988, p. 7). Many of these studies borrowed from mainstream economics and positivist strands of IR studies. As Murphy and Tooze argued nearly three decades ago (1991a, p. 19), “orthodox

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<sup>11</sup> Source: email correspondence with Professor Craig N. Murphy, 20 December 2016.

IPE scholarship displays a clear, if often unstated commitment to explaining events in terms of the rational action of individuals or of state actors treated as individuals — a commitment to a relatively radical form of methodological individualism that denies ultimate validity to contextually bound explanations as well as explanations in terms of concrete social wholes.”

Especially in the 1990s, IPE research was thought to have branches, namely liberalism, nationalism (or neo-mercantilism) and Marxism. In her 1993 book chapter, Lorraine Eden argued that each of these branches had a somewhat distinctive view of the MNE. According to her, the liberal viewpoint takes MNEs to be an integrating force for progress and thus “generally beneficial in their role as promoters of a more integrated world order, offsetting the mercantilist tendencies of nation-states” (Eden, 1993, p. 27). The neo-mercantilist approach, on the other hand, argued that MNEs “need to be regulated, both by national governments and internationally, according to the nationalist perspective, to ensure that state autonomy and sovereignty are maintained” (Eden, 1993, p. 27). Moreover, Eden argued that Marxist scholars, and Latin American dependency researchers in particular, “view MNEs as oligopolistic transnational capitalists that systemically exploit and promote underdevelopment in the periphery and semiperiphery, [...] enhancing imperialism and permanently creating global income inequalities” (ibid.). Finally, Eden argued that the liberalist and nationalist perspectives were largely captured by Vernon’s theories (the product lifecycle, sovereignty at bay, and the obsolescing bargain arguments), whereas Hymer’s theses captured the gist of the Marxist and dependency theorists.

Eden also argued that even though international business studies scholars have been aware of Marxist arguments, only contributions from the more mainstream strands of IPE scholarship are carried over into IB studies (Eden, 1993, p. 34). Moreover, IPE scholars typically know the canonical international business texts from Vernon and Dunning, as well as the most iconic business history accounts. However, in spite of these kinds of crossovers, it is clear that the IB focus on multinationals “differs from that of the IPE scholars, with IPE scholars generally taking the more critical view” (ibid.). Additionally, Eden argued that the IPE literature had lagged behind IB studies in research on global multinationals (ibid.). It must be noted that these arguments were advanced in the late 1990s and that many things are different today — both for good and for ill. To begin with, apart from some very recent advances in tax avoidance research, there is arguably less interaction between these two schools today than there was in the 1990s.

Until the late 1980s, IPE research covered a broad array of theoretical approaches, from dependency theory to Marxism and beyond. However, by the 1980s, a new school of IPE research known as Open Economy Politics (OEP) emerged from this cacophony as other approaches gradually fell out of favor (Lake, 2009, p. 49). Open Economy Politics shared several assumptions with mainstream economics. For example, it granted international trade a privileged position as a research topic and presented a “particular hierarchy of

other, less-valued, issues” (Murphy & Tooze, 1991a, p. 26). More specifically, OEP departs from the view that sets of individuals, be they firms, sectors or factors affecting production, share almost identical interests. These interests, in turn, are derived from economic theory. After OEP specified the interests of various entities, it “turn[ed] to how these interests are aggregated through domestic political institutions” (Lake, 2009, p. 50). Even though some scholars focus on one step or another in this process, much of the current mainstream IPE research has the same underlying logic (Lake, 2009, p. 51). As a consequence, today, the largest disciplinary sub-section within IPE scholarship consists of several variations of neoclassical economics (Palan, 2013, p. 2). Recently, mainstream IR research has expanded toward behavioral economics (Hafner-Burton, Haggard, Lake, & Victor, 2017), which is in line with the growing prevalence of this orientation within mainstream economics, but this has not altered the underlying situation.

Open Economy Politics has been more popular in the United States but slightly less popular in Europe. This has inspired many scholars to refer to American and British schools of IPE, a distinction made famous in IR circles by the intellectual history of IPE written by Benjamin Cohen (2008, pp. 3–4). The American school is closely aligned with OEP and “deeply embedded in the standard methodology of the social sciences which, stripped to its bare bones, simply means stating a proposition and testing it against external evidence” (Krasner, 1996, pp. 108–109). However, as Higgott and Watson have argued (2007), this bipolar categorization is not only inaccurate but also detrimental to any serious efforts to bridge the gaps between various schools of IPE, which appears to be the opposite of Cohen’s intentions.

Higgott and Watson compare Cohen’s characterization with Thomas Kuhn’s notion of competing paradigms in science (Kuhn, 2012). However, for Kuhn, the contesting paradigms are never clearly defined, unlike the clear distinction between American and British IPE that Cohen advocates. According to Higgott and Watson (2007, p. 1), Cohen’s own work would place him more on the British than the American side of IPE (even though he is American). Moreover, Higgott and Watson point out that while Cohen calls for a dialogue between the two orientations, his way of picturing “very different notions of both the goals and the methods of social scientific research” would not allow for genuine dialogue should each of these methods be an accurate portrayal of reality (2007, p. 4). Even more worrying for Higgott and Watson is the idea that “by aligning this presentation with arguably the prime international relations metaphor of inter-state competition, [Cohen] threatens to reinvent for IPE a systematic struggle over methods which has occurred before in other subject fields and which has had attendant adverse effects on the subsequent breadth of scholarship” (Higgott & Watson, 2007, p. 8).

Given its focus on a positivist state-centered system, the OEP strand of IPE has provided few tools for analyzing the political aspects of large enterprises. This has been accompanied by a more general shift in attitudes towards MNEs. As Lall argued in 1998 (Lall, 1993, p. 122), “the heat of the debate surrounding

the role of Multinational Enterprises (MNEs) in developing countries has subsided considerably in recent years,” because the closing years of the 1980s “witnessed a general warming of attitudes to foreign direct investments, not just in the development literature, but also on the part of the national governments that were traditionally strongly hostile to multinationals.”

It could be questioned whether the more structuralist accounts of IPE could be more helpful for analyzing corporate power. Earlier, it was noted that the emergence of IPE was predated by various schools of Marxist and developmentalist scholars, from Wallerstein to Baran and Sweezy. These structuralist theories contributed to the birth of the neo-Gramscian theoretical framework, which emerged in the early 1980s, especially through the work of Robert Cox (1981, 1983). Cox’s original contribution was influenced by Wallerstein’s world-system analysis, which he saw as one of the building blocks for a more comprehensive theory (Cox, 1981, p. 127; Patomäki, 2003, p. 197). Wallerstein’s (1974) main argument was that a single, capitalist world-economy had existed for five centuries, characterized by unequal power relations between the core and the periphery of the world economy. Cox criticized this approach for its apparent structural determinism and “developed more thoroughly historicist concepts such as relations of production, social classes and forces, forms of state, world orders, and hegemony” (Patomäki, 2003, p. 197).

A few years later, Stephen Gill and David Law (1988) introduced their own neo-Gramscian vision for the global political economy. Like Cox, “Gill and Law argued that a political economy analysis should not be narrowly limited to examining diplomatic relations between governments of modern nation-states, which are taken as given, and a few additional actors such as non-governmental organisations (NGOs) and other international organisations” (Patomäki, 2003, p. 197). Instead, the focus should be on the underlying historical processes (particularly in production) that shape the forms of world orders and states (Gill & Law, 1988). In line with the burgeoning globalization literature and in contrast to Wallerstein, Gill and Law also argued that the economic globalization of the time was of a different nature than the centuries-old world economy described by Wallerstein. However, Gill and Law also framed the political economy quite conventionally as an integrated field encompassing “the specialised disciplines of politics, economics and international relations,” excluding accounting and other business studies (Gill & Law, 1988, p. xviii; Gilpin, 1987, p. 5). Regarding MNEs, Gill and Law introduced a wide range of viewpoints, from those of corporate transnationalization theorists to those of Richard Barnett and Ronald Müller. The approach was mostly descriptive. Gill and Law did not go very far in tying corporate power to the broader frameworks of global political economy.

This garnered Susan Strange’s attention in her later major works, especially *States and Markets* and *The Retreat of the State*. In the introduction to *States and Markets*, Strange (1994, p. 12) noted that contemporary international political economy has “been too much dominated by the American academics

and has therefore been permeated by many hidden and even unconscious value-judgments and assumptions based on American experience.” Strange called for a synthesis of politics and economics “by means of structural analysis of the effects of states — or more properly of any kind of political authority — on markets and, conversely, of market forces on states” (1994, pp. 13–14). Her own proposal for a theory that could take into account states, corporations, and other actors centered on the concepts of structural and relational power that Strange saw as the four key dimensions: production, security, finance and knowledge (1994). Acknowledging the importance of structural power and expanding the framework of analysis used in traditional IR theories was a clear achievement, but one cannot find the elements of a comprehensive framework for analyzing MNEs in her work. Whatever merits she had as a theorist, her work was driven by empirics (Palan, 2000). This is particularly evident in her discussion of the power of MNEs, a theme present in Strange’s 1970 manifesto.

One point that emerges from this brief review is that none of the strands of the IPE project paid sufficient attention to developments in studies of political economy that were conducted outside of mainstream economic and international relations research. This is unfortunate, because several important analyses regarding corporate power and its manifestations emerged in the 1970s. These studies either went unnoticed in the IPE literature or were merely referred to without further theoretical discussion or development. Eventually, the 1980s saw the demise of many of these strands of research, and it took a lot of time and effort for IPE scholarship to reach the level of analysis championed by the earlier generations of researchers, especially the level of knowledge about the legal and accounting aspects of corporate power. While multinationals have been studied in the IPE literature, “their presence is often implicit rather than explicit, or segregated from other questions” (Eden, 1993, p. 26).

This demise of the research agenda regarding corporate power resulted from many overlapping factors, as described in the first article of this dissertation. One factor was the defunding of the UNCTC by the Reagan Administration. A second factor was the rapid change in the logic of international business in the 1970s. The oil crisis was a major blow to the big oil companies, which many people had thought were invincible. This created a sense that perhaps big business was not as powerful as had been thought (Gilpin, 1987, p. 232). As Robert Gilpin noted in his textbook *The Political Economy of International Relations* (1987, p. 232), “within a relatively short period of time, the gigantic oil companies — previously the quintessential international corporations — had had many of their foreign subsidiaries nationalized and had become subservient to states earlier considered powerless and servile.” Gilpin noted that the geographical changes involved in the spread of international business began in the 1970s, when rapidly growing rivals from Japan, South Korea, and elsewhere challenged the American military industrial complex that John Kenneth Galbraith and others had

described. The increase in chained forms of production was also already evident in the late 1980s, when Gilpin wrote his book (1987, pp. 254–256).

Whatever connections there had been with the corporate theorists of the early 1970s, and with heterodox developmentalist economists, were either lost or marginalized. When the World Bank and the IMF began designing their far-reaching structural adjustment programs after the emergence of the Latin American debt crisis in 1982, no viable research community existed to focus on the dangers of corporate power. This facilitated the growth of the research and policy agenda around rent seeking, which is most famously associated with the 1983 World Bank working paper *Price distortions and growth in developing countries* by Ramgopal Agarwala (Stein, 2008). During the 1980s and 1990s, these ideas evolved into a much broader and almost universally shared anti-corruption narrative that focused on state failures in the global South. The research agenda on corporate power was in tatters.

There were other factors involved in the demise of the research agenda on corporations within IPE. Above, it was noted how, within Marxist literature, Baran, Sweezy, and others had inspired a group of scholars to conduct research on the monopoly power of large MNEs. However, much of this moderate interest (Sweezy & Magdoff, 1968, p. 1) within Marxist studies waned as labor process studies gained increasing popularity from the mid-1970s onward within this field. In the words of one prominent Marxist theoretician of MNEs, Hugo Radice, “those of us who had been studying TNCs [transnational corporations] were quickly drawn into these new areas of study” (Radice, 2014, p. 24). Moreover, in the “real world,” the Friedmanian revolution started by Reagan, Thatcher and their advocates shifted the focus of trade unions, parties, and “a considerable part of the intelligentsia” to “local struggles, fighting rearguard actions against the tide of free-market ideology and policies” (Radice, 2014, p. 26). As a part of this development, Marxist scholarship retreated, and the “trench warfare against the neoliberal onslaught was not conducive to grand theorizing” (Radice, 2014, p. 27).

These changes in world politics and international political economy contributed to the decline of interest in corporate power as a research subject, even though the study of MNEs “certainly enjoyed a renaissance during these two decades, as part of the ‘grand narrative’ of globalization” (Radice, 2014, p. 27). The gaps in the understanding of the history of these ideas were most likely deepened by a broader development in which economists, political scientists and legal scholars began to take the demarcation lines and fields of their respective disciplines for granted (Strange, 1994, pp. 15–16). However, the underlying problems did not disappear. The corporate planning mechanisms that Barnett and Müller described so eloquently in *Global Reach* were still exploited by MNEs regardless of whether they were based in the United States, Europe or Japan. Additionally, the rapid growth of the offshore economy of tax havens began during this period, furthering these developments. Unfortunately, researching the drivers, characteristics and

consequences of these transformations did not play a major role within IPE and IR scholarship for a long time.



## 4 TOWARD CONTEMPORARY THEORIES IN IPE

In the 1990s, calls started to emerge for a “new political economy” that would draw on a wider range of theoretical and methodological orientations than the mainstream OEP-focused IPE could offer. The structuralist theories discussed above can be seen as a part of that movement, but the movement also included scholars from backgrounds other than IR or economics. Some of the key calls for action in this regard were the founding of two new journals, namely *Review of International Political Economy* in 1994 (RIPE Editors, 1994) and *New Political Economy* in 1996 (Gamble et al., 1996). According to the first editorial of the former journal, the end of the Cold War had “seriously shaken the orthodoxies, thus providing a window of opportunity to bring together analyses of former opposed positions ... [through] genuine exploration of the possibilities of epistemological convergences” (RIPE Editors, 1994, p. 2).

The first editorial of *New Political Economy*, on the other hand, argued that the “methodology of the new political economy rejects the old dichotomy between agency and structure, and states and markets, which fragmented classical political economy into separate disciplines,” seeking instead “to build on those approaches in social science which have tried to develop an integrated analysis, by combining parsimonious theories which analyse agency in terms of a conception of rationality with contextual theories which analyse structures institutionally and historically” (Gamble et al., 1996, pp. 5–6). Similar calls were made a few years earlier in the important book *New International Political Economy* (Murphy & Tooze, 1991c). As part of this broader development, IPE scholarship also began to slowly catch up with the challenges posed by corporate tax avoidance, tax evasion and tax havens. However, the process has been a long one. For example, in identifying the gaps and omissions in the IPE literature in the late 1990s, Denmark and O’Brien (1997, p. 232) mention only feminist concerns, environment and labor, but not the lack of attention to MNEs and offshore finance.

Since the 1990s, several strands of studies on these topics have emerged and I introduce and discuss these studies using a three-fold categorization. In line with the focus on IPE/GPE, my focus is on studies that aim to understand the mechanisms, structures and actors behind offshore finance.<sup>12</sup> Regarding

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<sup>12</sup> However, it should be noted that much of the research on corporate tax avoidance has traditionally been conducted within business studies and related disciplines. Most of these studies have employed quantitative mechanisms, utilizing large datasets, for example for comparing the effective tax rates of large multinationals to other factors, such as the number of subsidiaries in certain tax haven jurisdictions (for reviews, see Dharmapala, 2014; Heckemeyer & Overesch, 2013; OECD, 2015a). This research has provided knowledge on the magnitudes of various tax-driven wealth flows, but it is not without problems. For example, the databases these

the strands of research that aim to understand the offshore economy and how it benefits MNEs, the first group of studies can be labeled as structural, as they aim to understand these phenomena as an important and permanent feature of contemporary capitalism. The second category of studies focuses on the political and social aspects of actors, in particular MNEs, but also individual investors and facilitators such as the Big 4 accounting firms. The third group of studies focuses on the ways that the offshore economy is governed, incorporating research that falls under the more traditional IR frameworks, as well as studies that focus on more unconventional means of governance. All of these partly overlapping groups of studies are relevant for my inquiry, although the first and the last groups are the most interesting ones. In what follows I introduce each of these categories in turn and discuss how my dissertation contributes to the accumulation of knowledge in these fields.

## **4.1 STRUCTURAL THEORIES OF OFFSHORE FINANCE**

After a decade of relative inaction during the 1980s and early 1990s (with some exceptions such as Johns, 1983; Murray, 1981), the societal and political power of MNEs started to make a gradual comeback in the IPE literature toward the end of the 1990s. However, the new wave of scholars approached this issue from a slightly different angle. Instead of taking MNEs as such as their focal point of analysis, the new body of research focused more on the structures of the world economy and its governance as it enables corporate tax planning and related phenomena. *The Offshore Interface* by Mark Hampton (1996) and *Offshore Finance Centers and Tax Havens: The Rise of Global Capital* (Abbott & Hampton, 1999) were two key early attempts to (re)introduce these themes into GPE. In particular, Hampton (1996, p. 69) laid the foundation for later conceptual advances by arguing that quasi-independent tax havens “are ‘within and yet without’ the mainland, having autonomy in some domestic areas but maintaining close ties in other areas such as monetary union, external affairs, education, language and culture, and, perhaps equally importantly, being seen by the rest of the world as regulated by a competent and honest jurisdiction.” “The ambiguity of these relationships,” Hampton and Levi (1999, p. 651) argued, “provides the offshore interface, which renders these micro-states extremely useful to international financial capital.”

In addition to these publications, Ronen Palan made seminal advances in the theoretical understanding of this “offshore interface,” which facilitated a

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studies rely on seldom have comprehensive information from tax havens, whose entire operational logic relies on maintaining high levels of secrecy. Moreover, aggressive corporate tax avoidance strategies often rely on jurisdictions that do not feature in the most common lists of tax havens, such as the Netherlands.

strand of studies that aim to understand and analyze offshore finance as a central feature of contemporary capitalism. Palan had published about the political economy of offshore finance in the late 1990s (Palan, 1998), but his most important contribution was the book *Offshore World* (2003). In this book, Palan expanded the scope of inquiry by analyzing the historical development of offshore finance as a symptom and consequence of broader developments of capitalism. Moreover, he argued that the existing research on offshore finance aimed “to isolate the subject at hand from a complex and confusing mass of extraneous information, to delineate its boundaries, and to work within those boundaries in order to understand the essential characteristics and processes at work.” Instead of this, offshore finance should be analyzed “within the context of a changing capitalist world economy” (Palan, 2003, p. 9).

Palan’s most important theoretical contribution was the introduction of the concept of commercialized sovereignty, in which states routinely employ their sovereign right to make laws and issue citizenships for commercial purposes (Palan, 2003, p. 148). Theoretically, *Offshore World* drew mostly on the French post-structuralist tradition, with limited engagement with the earlier IPE theories, mainstream or not. I comment on and extend Palan’s concept on the “Panama and the WTO” article, which discusses how the commercialization of sovereignty impacted another significant phenomenon in the world economy, namely neo-constitutionalism in economic governance (see below).

After Palan’s groundbreaking book, the scholarly focus of social scientific studies shifted from systemic-theoretical considerations to matters related to more specific issues of global tax governance and, to a lesser extent, development and taxation. Major theoretical advances in understanding the offshore interface or commercialized sovereignty have been rare. Recently, however, the Global Wealth Chain (GWC) framework developed by Seabrooke and Wigan (Seabrooke & Wigan, 2014b, 2017) has emerged as a potential building block for a more comprehensive research agenda. Building on the well-established concepts of global value chains (Gereffi, Humphrey, & Sturgeon, 2005; Gereffi, Korzeniewicz, & Korzeniewicz, 1994) and global production networks (Henderson, Dicken, Hess, Coe, & Yeung, 2002), the GWC approach calls attention to how “wealth chains hide, obscure and relocate wealth to the extent that they break loose from the location of value creation” (Seabrooke & Wigan, 2014a, p. 257). This also reflects the notion by Sikka and Willmot (2010, p. 353) of how accounting techniques “alter the statistics that governments use to manage economies.”

Seabrooke and Wigan called wealth chains “the yin to the yang of value chains” (2014a, p. 257). While value chains and production networks are characterized by relative transparency and coordination, actors in wealth chains thrive on the secrecy of the arrangements. Therefore, Seabrooke and Wigan argue for a need for “a clearer picture of how wealth chains have an impact on developed and developing countries” and on the role of financial

innovations in these wealth chains (2014a, p. 261). Noting how value chain research has focused on the disaggregation of production processes across space, Seabrooke and Wigan (2017) have suggested that in the era of the “decentred corporation” (Desai, 2009), the legal and financial disaggregation of the firm merits more attention. In contrast to Palan’s commercialized sovereignty framework, which relied more on post-structuralist researchers, the GWC concept can be seen as part of the continuum of world systems and dependency theories that influenced the early development of IPE.

I contribute to these studies first by providing a historical background to many of these ideas, and second by engaging with two different theoretical frameworks that are relevant for understanding the offshore economy: global wealth chains and neo-constitutionalism. Regarding the historical background, the first of my articles is titled “Back from Oblivion? The Rise and Fall of the Early Initiatives against Corporate Tax Avoidance” *from the 1960s to the 1980s*. The article focuses on the aforementioned analytical and policy work on corporate tax avoidance and tax havens conducted within the United Nations and the UNCTC primarily during the 1970s. Many analyses of corporate tax avoidance and tax havens have much older roots than is commonly understood. Based on a content analysis of the relevant reports UNCTC published between its inception and closure, I demonstrate how the weakening policy community in the UN and the failure of the OECD to take into account the earlier discussions on corporate power and tax avoidance contributed to the neglect of these discussions. Other factors were the reframing of the UN’s work on multinational enterprises to address human rights abuses instead of tax avoidance and the transformation of the academic theories of the firm.

Even though these developments took place during the formative years of GPE, the GPE literature published in this era largely omitted these developments apart from occasional references to some UNCTC reports (e.g. Strange, 1994, p. 247). This is unfortunate, not least because UNCTC’s analyses were surprisingly mature for their time, often bearing a striking resemblance to today’s discussions on tax avoidance and corporate power within the GPE and world politics literature. However, the key authors of these reports were typically not scholars of IR or mainstream economics. Many of them were practitioners and those with an academic background often seemed to associate themselves with international business, accounting or similar orientations. I believe that the heterogeneity of orientations and the consequent lack of a coherent theoretical school contributed to the limited interest and understanding of the issues discussed in the UN (and partially also in the OECD and within the U.S. government) among economists and IR scholars. Even though evolutionary economics has recently made some inroads into the GPE literature (Palan, 2013), the long-neglected status of this tradition is apparent in review that Denemark and O’Brien published on the development of the IPE studies within the IR scholarship. They mention only

the imperialism studies of the early 20<sup>th</sup> century as an example of early studies on IPE (Denemark & O'Brien, 1997, p. 231).

This first historical article is followed by a paper titled “Tax-driven wealth chains: A multiple case study of tax avoidance in the Finnish mining sector,” which enriches many of the discussions introduced in the previous article with more empirics and a broader conceptual framework. Written together with Lauri Finér, the article begins with a review of the tax practices of 10 companies mining metal ores in Finland. The setting is then narrowed down to three mines operated by two Canadian mining companies. The article makes theoretical inroads in a discussion of how the global wealth chains framework could be utilized in the studies of corporate power and global capitalism.

My third article, “Panama and the WTO: New constitutionalism of trade policy and global tax governance,” written together with Teppo Eskelinen, analyzes how the conceptual framework of commercialized sovereignty can be combined with the long-standing research orientation of new constitutionalism. The new constitutionalism framework has been popular, especially in the research of international trade and investment policies. Specifically, we demonstrate how the tax haven Panama has effectively resisted attempts to sanction secrecy structures by invoking World Trade Organization (WTO) rules. Consequently, we argue that the way trade treaties “lock in” policies can thus have a far-reaching impact on tax regulation: trade policy not only restricts the policy space but also provides tools for commercialized sovereignty (Palan, 2003) to maneuver against anti-tax evasion measures. We point out that any future trade agreements or revisions of old agreements could pose a threat to ongoing attempts to improve global tax governance. Effective global tax governance often requires the use of means that are not foreseeable when stipulating exceptions to trade agreements with typically rather wide policy scopes.

Another area in which interesting theoretical developments have taken place in recent years is in the study of MNEs as societal or political actors through facilitators and enablers of offshore finance. In the next section, I discuss some of the key studies in this field and my contribution to them.

## **4.2 THE FACILITATORS AND BENEFICIARIES OF OFFSHORE FINANCE**

Recent years have seen a growing — yet fragmented — body of research on the nature of the corporation and its societal impacts (e.g. Biondi, Canziani, & Kirat, 2009). Drawing on a variety of disciplines and research conducted over a century, these studies have provided important insights into the dominant understanding of the corporation in both national and domestic arenas

(Bowman, 1996, p. 14). In addition, important contributions have been made regarding the legal foundations of the modern corporation (e.g. Avi-Yonah, 1995; Biondi et al., 2009). Complementing this conceptual research, several strands of empirical studies on the non-market power of corporations have added to the more theoretically oriented scholarship. As early as the 1930s, Adolf Berle and Gardiner Means used extensive sets of statistical data on the concentration of American industries to develop their theoretical thesis on the separation of ownership and control in large corporations in their already mentioned landmark book *The Modern Corporation and Private Property* (Berle & Means, 1934).<sup>13</sup>

I contribute to this field with an article titled “The Politics of Intra-Firm Trade: Corporate Price Planning and the Double Role of the Arm’s Length Principle.” Written together with Teivo Teivainen, the article notes that transactions planned in corporate headquarters constitute a significant proportion of global trade. This intra-firm trade deviates from the basic ideals of the market economy as it takes place between units of the same corporate entity. States have addressed the mismatch between the theory of markets and the reality of price planning by agreeing on national and international norms for facilitating market-based transactions within big corporations, namely the separate entity principle and the arm’s length principle. The former states that companies belonging to the same enterprise are separate entities before the law. The arm’s length principle dictates that whenever two parts of the same corporate entity trade with each other, they should set the prices as if they were at arm’s length from each other (Eden, 2016).

Key scholars within tax law scholarship have addressed the legal and institutional aspects of corporate tax avoidance (e.g. Avi-Yonah, 1995, 2001, 2016; Christians, 2005; Durst & Culbertson, 2014; Eden, 2003; Kudrle & Eden, 2003; Picciotto, 1992, 2011). While not confined solely to tax law, these studies have been especially helpful in increasing our understanding of the legal environment that enables and facilitates corporate tax avoidance. In particular, legal scholars have pointed out how the separate-entity principle (i.e. that companies belonging to one group are treated as separate entities for tax purposes), and the arm’s length principle associated with it, have been dysfunctional almost from their inception in the 1920s. The underlying problems of these principles have only worsened with the growth of international trade in the subsequent decades.

However, a body of empirical research has shown that comparable prices are typically very difficult if not impossible to find. As a result, states have allowed multinational corporations to resort to various formulas when

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<sup>13</sup> It should be noted that some of their interpretations of the data were skewed and this error has since been repeated in other studies that draw on Berle and Means (Zeitlin, 1974). However, the basic thesis of business concentration in the United States is still relevant, and the theoretical framework that Berle and Means developed was of even more lasting importance, a theme that I discuss further in the subsequent sections.

determining their intra-firm prices. In the article, we argue that the arm's length principle has played a double role in world trade: its first, explicit purpose is to establish markets within multinational corporations. Based on decades of practical results, we argue that it has failed in this goal. The principle also helps in maintaining the current dysfunctional system of global tax governance and we note that the existing research has not acknowledged this ideological role. In conclusion, we argue that there are grounds for crossing the disciplinary border between politics and economics, and that intra-firm trade could also be analyzed as a political phenomenon inside the economic sphere.

### **4.3 THE (NON-)GOVERNANCE OF OFFSHORE FINANCE**

The governance of offshore finance has been a natural field of research in IPE. After a period of very little activity in the 1980s and early 1990s, the OECD's 1998 initiative against harmful tax practices was a definite milestone in answering the call for research that the G7 group had issued in 1995. The report was instrumental not only in igniting the still ongoing wave of action against tax havens, but also for sparking a number of IPE-related articles and books in the subsequent years. The 1998 report included far-reaching suggestions such as sanctions for capital flows entering tax haven jurisdictions. Jason Sharman (2006) documented the demise of this initiative in his seminal book *Havens in a Storm*. Around the same time, research started to emerge analyzing the OECD's 1998 initiative, its failure and other areas of international tax governance (e.g. Eccleston, 2012; Emmenegger, 2015; Sharman, 2008, 2011, 2012; Vlcek, 2013). As a result, international tax governance began to gradually emerge as a viable research topic in World Politics. While Thomas Rixen was right to argue in 2011 that "the *causes* of tax competition have received no attention" in the international political economy literature (Rixen, 2011, p. 3), the situation has improved markedly since then. Rixen himself has addressed the causes and consequences of corporate tax avoidance and tax competition — or "tax wars," as Christensen and Shaxson (2016) recently labeled this phenomenon — in several articles (Dietsch & Rixen, 2016).

Thus, the international political economy of tax havens, corporate tax avoidance and tax evasion has evolved into a distinct, interdisciplinary research area. It has largely been developed as a joint effort between scholars of international relations, international tax law, accounting, development studies, and so on. However, the aforementioned studies have focused predominantly on governance frameworks of tax avoidance and less on the corporate power over the states behind these phenomena. The recent lack of analyses of corporate power has been striking, given that the new millennium

has already seen a torrent of exposés and scandals related to corporate tax avoidance, tax havens and accounting frauds (e.g. Hearson & Brooks, 2010; Ting, 2014; Ylönen & Laine, 2015). These revelations have produced much research, but often from narrow, sector-specific viewpoints. Despite some interesting theoretical developments (e.g. May, 2006, 2015a, 2015b; Seabrooke & Wigan, 2017), attempts to develop broader frameworks of analysis have been few and far between.

Understanding tax avoidance, tax evasion, tax havens and corporate power calls for inter-disciplinary approaches. Tax arrangements are often based on complex accounting techniques. The national and international legal frameworks that aim to regulate corporate tax arrangements also need to be taken into account. National, international and global politics can shape both accounting rules and the legal environment. Perhaps unsurprisingly, accounting and legal scholars have also been most active in researching tax avoidance. However, most of the research in accounting has focused on large datasets instead of aiming to understand in detail how corporate tax avoidance operates in the real world.

Governance is a broad field, and in some respects all of the articles of this dissertation contribute to these studies, including the aforementioned article on Panama and the WTO. Trade policy is not the only policy field that can impact efforts to enforce tax regulations. During the past 35 years, the loan conditionalities imposed by the IMF and the World Bank have played a major role in determining tax policies in low-income countries around the world. Around the turn of the millennium, several scholars noted the generic, one-size-fits-all nature of the IMF's tax policy recommendations, labeling them as the "global tax consensus." Among other things, this consensus focused on lowering corporate income tax rates, the introduction of or increasing reliance on value added taxation, and structural reforms of tax administrations. In the current millennium, the use of loan conditionalities has somewhat diminished in IMF loans and the issue has become less salient. Through an analysis of IMF country reports from several sub-Saharan African countries, I revisit the global tax consensus debate in a UNU-WIDER working paper titled "Policy diffusion within international organizations: A bottom-up analysis of International Monetary Fund tax work in Panama, Seychelles, and the Netherlands" (Ylönen, 2017).

The final article focuses on the "spill-over effects" of the increasing salience of tax issues in global policy forums. The article *Cities as world-political actors?* "The "tax haven-free" cities initiative and the politics of public procurement" analyzes recent efforts to introduce tax-related criteria to public procurement tenders in Helsinki and Malmö. Comparing the "tax haven-free cities" initiative with the established "Fair Trade Cities" movement, the article illustrates how cities can utilize public procurement to promote world-political goals. I also show how the increasing complexity of the required procurement criteria can make the success contingent upon help from "emergent entrepreneurs" of social movements (Seabrooke & Wigan, 2013). These



developments highlight the contradictory and complex effects of the “economization” and “marketization” of the political sphere (Çaliskan & Callon, 2009, 2010). While economization isolates many societal issues from political control, it can also allow for politicizing local and global issues in ways that were hitherto unthinkable.

Finally, regarding the societal aspects of corporate tax avoidance, the body of research produced by critical accounting scholars such as Prem Sikka needs to be highlighted. While Sikka and his colleagues have published predominantly in accounting journals, their work has had a crucial role in bringing these questions to scholarly attention beyond their own discipline. Together with Hugh Willmott and others, Sikka has analyzed the role of accountants in facilitating tax avoidance in several studies in the 1980s and the 1990s (Sikka, 2008; Sikka & Willmott, 2010; Sikka, Willmott, & Lowe, 1989). While these studies focused mostly on the societal power of the accountancy profession within the United Kingdom, later studies expanded the focus to include the role of the Big 4 auditing firms in facilitating tax haven-related flows (e.g. Sikka & Hampton, 2005).

By the mid-2010s, corporate tax avoidance research had become a broad, inter-disciplinary and methodologically diverse field. Even though the research agendas in individual disciplines may still be in their infancy (Rixen, 2011, p. 3), there is a significant number of recent studies on corporate tax avoidance and its impacts. To give a few examples, recent years have seen emerging research agendas on the relationship between tax avoidance and corporate social responsibility (e.g. Hasseldine & Morris, 2013; Sikka, 2013; Ylönen & Laine, 2015), on why corporate tax avoidance is an issue for developing countries (e.g. Bräutigam, Fjeldstad, & Moore, 2008; Durst, 2016), and on the philosophical and ethical aspects of tax avoidance (e.g. Dietsch & Rixen, 2014; Pogge & Mehta, 2016). Given the inter-disciplinary nature of these issues on the one hand, and the disciplinary gaps between various groups of corporate tax scholars on the other, there is clearly a need for more comprehensive approaches. Much of the research on tax havens has focused on state strategy, which “can be highly misleading” because we may end up missing “a crucial aspect of tax havens unless we pay close attention to the commercial firms that service them” (Palan, Murphy, & Chavagneux, 2013, p. 12). The studies on corporate tax avoidance and offshore finance have also paved the way for an IPE/GPE research agenda on corporate power, but this has not yet fully emerged. What gaps and omissions remain? I conclude by focusing on this question in the final section below.

## 5 WAYS FORWARD

“The [global] company views the world as a single entity. Its perspectives transcend all national boundaries. Decisions are made not in terms of what is best for the home country or any particular product group, but in terms of what is best for the corporation as a whole on an international basis.” (Business International 1967 in Adám, 1975, p. 90)

Compared to the traditional strands of IR, World Politics does not start “within a distinct body of literature; it is one that draws a broad range of literatures around its subject instead” (Albert, 2016, p. 5). In recent years, scholarship in World Politics and GPE has finally started to pay serious attention to the societal powers that MNEs harness through their tax-avoidance opportunities. As demonstrated by the preceding analysis, this development has been far from straightforward. The societal and political powers of MNEs have emerged as a research topic in various phases of the development of IPE and GPE. Moreover, these advances have been highly contingent upon developments in related disciplines, such as evolutionary economics, development studies and critical legal scholarship. Overall, this research has been scattered. Researchers have often paid insufficient attention to advances in related disciplines, resulting in major gaps both in institutional memory and in the quality of analyses. This recurring loss of institutional memory has been accentuated by the lack of comprehensive, inter-disciplinary textbooks in this area.

In a development culminating in Kenneth Waltz’s iconic 1979 book *Theory of International Relations*, much of the IR research in America and many other countries has been concentrated around the neo-realist school of IR. The neorealist research agenda focuses on the power-political interests behind state actions and the effects this has on the “anarchical” system of international relations. Consequently, it is ill-equipped to provide tools for understanding the political nature of corporations in the global economy. The mainstream IPE is largely concerned with states, or at most with the interest groups that affect state policies. This rigid market-politics separation hinders attempts to understand the corporate-driven offshore economy. If one agrees with the presumption that the economic decisions of corporations can have political impacts that could be compared to those of some smaller states, we need to reconsider many of the key assumptions present in the traditional theoretical debates in IR and IPE. Especially within IR, a great majority of the theoretical debates have focused on the role of state interests in shaping international relations or other forms of international/global governance.

Neo-realism’s chief intellectual rival in some academic circles, constructivism, is potentially slightly more useful in its focus on the social and

historical construction of international relations. It is evident that various historical and socially constructed ideas play a major role in sustaining the juridical-political structures that support the current corporate interests in the world economy. However, much of the constructivist research also focuses on the role of various expert groups and advocacy organizations in shaping the alignments of individual states in international relations. These studies have been useful in highlighting the role of corporate interest in policy-making, but they are not as helpful in addressing the political aspects of the economic power of large MNEs.

However, as this introductory chapter and other articles of my dissertation demonstrate, World Politics needs to extend beyond these conceptions that focus on ideas or state-centric power politics. Specifically, there is a need for a research agenda that pays respect to the role that MNEs play in the global political economy, which would draw on various disciplines, ranging from critical legal scholarship to evolutionary economics. This way, we can achieve a nuanced and comprehensive picture of the role of corporations in the world's power structures, and pave the way for better frameworks for understanding how the global political economy actually works.

With the torrent of recent research within the GPE scholarship, a research agenda has now been established around corporate tax avoidance, its governance, and to some extent on the role that corporations play in these dynamics. Yet as the articles of my dissertation demonstrate, there are still several major gaps and omissions that require attention. Naturally, social reality is too complex for a full explanation and a selection must be made. But in the absence of the laws of natural science, the social sciences need to start from the individualities that form the social phenomena in their unique configurations. We need theories to "explain some aspect of the international system that is not easily explained by common sense" (Strange, 1994, p. 11) and there has certainly been a lack of frameworks for understanding the power-related aspects of MNEs. I agree with Patomäki (Patomäki, 2002, p. 14) that "instead of armchair philosophising," most meaningful research should be "about encountering, collecting and analysing empirical evidence."

Very recently, a research agenda has started to emerge around MNEs, again combining elements from various earlier strands of research. Spearheaded by scholars of global political economy, as well as critical legal scholars, accounting researchers, and beyond, these studies have taken the IPE/GPE project closer to its initial foundations. As I have argued in this overview, IPE was not merely a marriage of international economics and international relations, as textbooks often portray it to be. Rather, the new research agenda around IPE arose from a variety of sources, including critical accounting and legal scholarship conducted within the UNCTC and other groups. During the formative years of IPE, there was also frequent interaction between International Business studies and IPE studies. Both these disciplines debated ideas put forward by Hymer, Vernon and others. Today, this linkage has been largely broken.

Spearheaded by scholars of GPE, tax law and other disciplines, a group of scholars have recently started to create new theoretical openings around companies as nationally-based accounting entities on the one hand, and as centrally managed and coordinated real entities on the other (Avi-Yonah & Sivan, 2007; Biondi et al., 2009; Robé, Lyon-Caen, & Vernac, 2016). Drawing on the early evolutionary economics of John Commons and other sources, this approach currently has the best potential for providing a bridge between the IPE research on offshore finance and corporate tax avoidance on the one hand, and the active political agency of the MNEs on the other hand. This theme is also discussed in depth in the article I wrote with Teivo Teivainen (Ylönen & Teivainen, 2017). However, it remains to be seen how well these approaches will be integrated with the mainstream IPE/GPE literature.

Max Weber has said that “the social science that we want to concern ourselves with is a *science of actuality* ... of the life in which we are placed—on one hand, the coherence and cultural *significance* of individual occurrences in their contemporary configuration, and on the other hand, the reasons for those occurrences being historically so and not otherwise” (Weber 1999, pp. 170–171, quoted in Jackson, 2011, pp. 20–21). In other words, there “is no fundamental opposition between ‘explaining’ and ‘understanding,’ as both are equally scientific” (Jackson, 2011, pp. 20–21). It is impossible to understand corporate tax avoidance in its broader societal context by focusing on only one aspect — say, tax avoidance arrangements or the political efforts to address them. Therefore, there is a need for a variety of research settings as well as methodological diversity.

In the field of international business studies, Jones and Khanna have argued that scholarship “should evolve its rhetoric of the relatively uncontroversial idea that ‘history matters’ to exploring how [it] matters” (Jones & Khanna, 2006, p. 453). This is something I have attempted to do by exploring how the scholarship of the societal powers of MNEs has developed within various disciplines. There is an urgent need for this kind of research not only in World Politics, but also in IB circles, as “it is fair to assert that systematic investigation of historical evidence has disappeared from the research agenda of most IB scholars, in parallel with a decline in the teaching of history in US business schools (Van Fleet & Wren, 2005). This may reflect the growing strength of the disciplines, especially in US institutions, at the expense of multidisciplinary, topic-based departments such as IB” (Jones & Khanna, 2006, p. 454). As Jones and Khanna (2006, p. 465) have argued, “current IB scholars are generally not trained to use rigorous methods suited to small-sample and qualitative data.”

The key pillar of the corporate planning system is the modern corporation, with its separate legal personality and right to own other companies. Without these properties, the other pillars of the corporate planning system would not survive. As has been demonstrated, from a legal viewpoint, corporations are created by states. However, as Berle and Means discussed as early as the 1930s, in everyday business activities, modern corporations operate as

enterprise entities (Biondi et al., 2009) that essentially plan their businesses in order to advance the broader goals of the firm and use whatever legal means and forms they find necessary to achieve their targets. As Biondi argues, an enterprise entity is “a comprehensive approach to the firm that integrates accounting, economics, and law, thus improving on the received understanding of the firm” (Biondi, 2013, p. 394). This approach departs from a realization that in order to navigate in contemporary markets, management cannot rely merely on outside market pricing. Instead, management must maintain accounting systems “that are modes of looking inside the ongoing enterprise” (Biondi, 2013, p. 402). These accounting systems enable key actors — management, regulators and stakeholders — to understand and govern corporations.

One additional concept needed to understand the international foundations of the contemporary corporate planning system is new constitutionalism, which becomes important when shifting the analytical focus from the national to the international level. Originally introduced by Stephen Gill (1998, 2008), new constitutionalism refers to the various ways in which the rules of the international economy become locked into international treaties through a process whose outcome shares similarities with the role of constitutions at the national level. In other words, these international treaties create a strong, binding legal framework for the world economy. As is the case with state-level constitutions, changing these international rules has been made intentionally very difficult. The result has been an increase in the power of MNEs and investors over citizens and states. In Gill’s words, the outcome “confers privileged rights of citizenship and representation to corporate capital, whilst constraining the democratization process that has involved struggles for representation for hundreds of years” (Gill, 2008, p. 139).

The guidelines and bilateral tax treaties that govern intra-firm trade perform this kind of new constitutionalist function for the international corporate planning system. Specifically, the arm’s length principle and the guidelines and treaties to which it has been codified essentially lock in the regulatory system that gives MNEs disproportionate rights to decide where they want to book their profits. Tax treaties stipulate the ways in which the undersigning states decide to divide the taxing rights for different types of income streams regarding individuals and corporations. While the original intention of bilateral tax treaties has been the prevention of double taxation, these treaties can also be designed with the specific purpose of granting MNEs or individuals opportunities to escape taxes in both countries. This is especially the case with some tax havens whose development or industrial policy model relies on attracting disproportionate flows of investment or corporate wealth. This dynamic facilitates the growth of the financial sector and generates income through, for example, registration fees and indirect taxes.

The most powerful OECD countries determine the rules for this transfer of power from states to MNEs. The specific ways in which this new

constitutionalism of intra-firm trade erodes state sovereignty differ across countries. Generally, larger countries are best equipped to mitigate the harmful effects of the current arm's length principle because these countries have greater administrative resources and various sources of power that allow them to engage in direct negotiations with MNEs and even make outright threats to make business more difficult. On the other hand, smaller and less-developed countries are most likely to suffer. In general terms, large MNEs operating in small countries are more likely to engage in the use of political, non-market pricing power than small MNEs in large countries.

The decision that the League of Nations made in the 1920s to abstain from the use of unitary taxation in dividing the rights to tax MNEs' different income streams from different states essentially created one crucial component of the international corporate planning system. By embracing the seemingly market-based arm's length principle and the separate entity principle, states effectively gave private actors the power to decide on an important aspect of the international distribution of wealth flows. It was this power that also facilitated the development of the phenomenon of "commercialized sovereignty," a term coined by Ronen Palan in his articles and 2003 book *The Offshore World* (Palan, 1998, 2003). Essentially, Palan argues that acknowledging the importance of tax havens as mediators and facilitators of global capital requires re-evaluating the conventional understanding of the relationship between the state and globalization, as well as the notions of agency and change in international forums (Palan, 1998, p. 627).

In contrast to the body of literature claiming that globalization has eroded sovereignty, Palan argues that the growth of the offshore tax economy has resulted in a radical redrawing of sovereignty. Essentially, tax havens have managed to turn their sovereignty into a tradable asset by tailoring their tax laws, transparency requirements and other regulations to best serve the needs of international investors, large MNEs and even organized crime. In respect of international finance, this development began in the 1950s with the emergence of the Eurodollar market in London in a juridical process in which the British courts declared that British laws did not apply to the trade of dollars conducted by foreigners in London. As Eurodollar trade falls outside of British jurisdiction while taking place within British borders, it essentially happens in a juridical vacuum (Burn, 2006).

Other juridical innovations that enabled the emergence and growth of commercialized sovereignty are early holding company laws in the United States and the institutionalization of modern banking secrecy in Switzerland in the early 1900s (Fehrenbach, 1966), although the latter invention was more relevant for investors than MNEs. The holding company laws gave companies the right to own other companies, and enabled the birth of the large holding companies that were registered in Delaware and other U.S. states that offered them generous benefits, even though they had little or no actual presence there. The Swiss invention of banking secrecy, on the other hand, brought the violations of the old professional secrecy practices under criminal law.

The offshore world of tax havens centers around large financial hubs (especially London), but equally important are smaller tax havens such as the Cayman Islands, Jersey, and the Netherlands Antilles. As the development of the offshore economy progressed, some of these tax havens benefited from tax treaties with “onshore” states that enabled easy repatriation of profits, while others began to specialize in tailoring different industries and customer groups.

As can be seen from this overview, tax havens’ operating models are actually supported by two main drivers: investor capital and corporate holding company structures. These drivers have been labeled as “sink” and “conduit” jurisdictions. “Sinks” refer to places that specialize in offering investment products, whereas “conduit” countries include jurisdictions, such as the Netherlands or the British Virgin Islands, whose holding company regimes are often used by MNEs to channel investments (Garcia-Bernardo, Fichtner, Takes, & Heemskerk, 2017). Essentially, the tax treaty network of these conduit countries enables MNEs to repatriate profits from other offshore jurisdictions to their headquarters in Europe, America or elsewhere in the world with little or no tax. The corporate planning system is more connected to conduit jurisdictions that play a central role in the international corporate planning system. In many cases, these conduit jurisdictions are not tax havens in a sense that they would offer stringent bank secrecy or other forms of confidentiality for investors. On the other hand, the aggressive APAs that some key conduit countries supply offer equally important non-disclosure of artificial intra-firm pricing policies.

A further point of interest is the dynamics between the non-market aspects of the arm’s length principle and commercialized sovereignty. Without the non-market planning power that the dysfunctional arm’s length principles provides, MNEs would find it significantly more difficult to benefit from the commercialized sovereignty of tax havens. However, the glaring loopholes in the current international tax governance — most notably the arm’s length principle — have enabled MNEs both to exploit commercialized sovereignty and to increasingly operate in close cooperation with both lawmakers in conduit countries and the Big Four tax advisory companies to design legislation that facilitates the growth of the international corporate planning system (Sikka, 2008; Sikka & Hampton, 2005).

While the exact definitions applied to power vary, there is currently a broad consensus in social sciences that power is more of a process than something that takes place in particular venues. This is exactly how this concept should be understood also in relation to corporations. Since the 1980s, this view has been further solidified by the work of feminist researchers (Butler, 1990), scholars of social movements (Teivainen, 2005), and the body of scholarship produced on private forms of decision-making (Nölke, 2011) — to highlight just a few significant examples.

By mapping the evolution of the research agenda on corporate tax avoidance and corporate power, I have aimed to provide building blocks for a

more holistic understanding of the role of corporations in the global political economy and world politics. The articles that are an integral part of this dissertation serve the same purpose by looking at corporate tax avoidance and the political power of corporations from various angles, including the broader structures in which tax avoidance takes place. Therefore, these articles also provide building blocks for developing more comprehensive theories of the corporation. As Pieterse (2013, p. 178) has noted, theories are contextual in a sense that “a careful look at practice can generate new theory, and theory or theoretical praxis can inspire new practice.” Moreover, while “theories react to other theories and often emphasize differences rather than complementarities, the complexities encountered in reality are such that we usually need to combine several analytical approaches” (ibid.).

Finally, one thing that connects many of the following articles is their call for methodological diversity in the research of MNEs and their governance in general and corporate power in particular. Specifically, when studying complex entities such as MNEs, it is of crucial importance that methodological choices are firmly grounded in the research questions and research material. While one could think that this is a self-evident point when doing research, too often researchers in, say, International Business studies, tend to employ statistical and econometrial methods whereas IPE scholars focus more on qualitative methods. There are similar biases in the research on the governance of MNEs and tax havens. In order to address these issues, the subsequent articles also explore paths for developing new kinds of methodologies. In particular, the *Tax-Driven Wealth Chains* article develops a methodological approach around qualitative financial accounts research. Apart from some exceptions (Ylönen & Laine, 2015), this approach has barely been utilized when researching corporate tax avoidance, despite its merits. Moreover, *Policy Diffusion within International Organizations* takes a fresh approach to the study of the IMF through its qualitative research on the IMF’s country reports.

All articles in the dissertation have been published in double-blind peer-reviewed journals, with the exception of the working paper *Policy Diffusion within International Organizations*. While this particular paper has not undergone double-blind peer review, it was researched and written under the close supervision of Dr. Pia Rattenhuber from UNU-WIDER and it was also subject to approval by UNU-WIDER’s working paper acceptance process.



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# **Back from oblivion? The rise and fall of the early initiatives against corporate tax avoidance from the 1960s to the 1980s**

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Tax havens and tax avoidance have gathered much interest, e.g., in the United Nations (UN) negotiations on the post-2015 development goals. The analyses of initiatives against corporate tax avoidance typically focus on developments from the mid-1990s onward. This article shows that contrary to the common perception, the country-by-country reporting initiative and many of the other contemporary policy responses had already been developed and discussed in the 1970s by the United Nations Commission and Centre for Transnational Corporations. I demonstrate how the weakening of the policy community of the UN and the failure of the Organisation of Economic Co-operation and Development (OECD) to refer to the earlier discussions, not only in the UN but also in the OECD, contributed to the passing into oblivion of these ideas. Other factors were the reframing of the UN work on multinational enterprises to human rights issues and the transformation of academic theories of the firm. The examples demonstrate how ideas shape world politics and how the oblivion of certain ideas can have concrete impacts on the power relations between its actors. The oblivion of the earlier debates paved the way for the triumph of more business-friendly discourses centred on the anti-corruption and corporate social responsibility arguments.

**Keywords:** United Nations, transnational corporations, development, transfer pricing, country-by-country reporting, accounting

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## 1. Introduction

*Transnational corporations should/shall not, contrary to the laws and regulations of the countries in which they operate, use their corporate structure and modes of operation, such as the use of intra-corporate pricing which is not based on the arm's length principle, or other means, to modify the tax base on which their entities are assessed. – Draft United Nations Code of Conduct on Transnational Corporations, 1983*

*Exchanges of information between tax administrations through the application of tax agreements could not be regarded as a very effective method of putting an end to the flight of capital, and more comprehensive international co-operation was therefore required in that field. – United Nations Ad Hoc Group of Experts on Tax Treaties between Developed and Developing Countries, 1970*

In September 2013, the G20 group mandated that the Organisation for Economic Co-operation and Development (OECD) start the Base Erosion and Profit Shifting (BEPS) project, which aimed to produce international tax rules that would tax transnational companies (TNCs) where economic activities take place and where value is created. This marked the start of an intensive two-year negotiating process, with the outcome documents agreed upon and published in October 2015. The rules that govern intracompany trade received some fixes and improvements, and a few pressing initiatives, such as country-by-country reporting, saw significant progress. However, the results failed to impress critical observers, as much of the present corporate tax avoidance will continue unabated even after the BEPS resolutions take effect (BEPS Monitoring Group, 2015).

Despite its deficiencies, the BEPS process can be seen as the culmination of the OECD-led efforts to champion the international tax regime (Ring, 2007: 598), especially since the publication of the OECD's *Harmful Tax Practices* report in 1998 (OECD, 1998). The report was an answer to the 1996 call from the G7 countries to develop measures to counter the distorting effects of harmful tax competition on investment and financing decisions and the consequences for national tax bases.<sup>1</sup>

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<sup>1</sup> Specifically, the 1998 report set out a proposal to establish guidelines on the identification of harmful preferential tax regimes, called for the creation of a forum on harmful tax practices, called for the development of a list of tax havens and suggested a number of recommendations for action at the level of national legislation and in tax treaties.

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Since then, the history of anti-tax haven and anti-tax avoidance initiatives has usually begun with reference to that 1998 report, which had the bold subtitle of *An Emerging Global Issue* (OECD, 1998; see also Eccleston, 2012: 100; Eden and Kudrle, 2005: 107–108; Hampton and Christensen, 2002: 1659; Weiner and Ault, 1998: 601).

This is not a big surprise, as the 1998 report made no reference to any studies published prior to the 1980s. Illustratively, the first sentence of the introduction set the general tone, stating that “historically, tax policies have been developed primarily to address domestic economic and social concerns” (OECD, 1998: 13). Ironically, the OECD even failed to refer to some of its own earlier work to counter tax avoidance and tax evasion. However, this article demonstrates the need to look further back in history in order to understand both the origins of the policy discussions on tax havens and the initiatives to tackle the international tax flight. Specifically, the article illuminates the rich body of analyses and policy initiatives produced by the various agencies and groups under the United Nations (UN) umbrella. I show how the UN and its Centre for Transnational Corporations (UNCTC) originally developed, considered and promoted many of the initiatives that have gained prominence especially in the post-financial crisis era.

With this exercise, I provide new information for the intensifying policy-focused and analytical debates on tax havens, tax evasion and tax avoidance (e.g. Christensen and Murphy, 2004; Christensen, 2011; Dietsch and Rixen, 2016; Palan et al., 2013; Picciotto, 2011; Pogge and Mehta, 2016; Slemrod and Wilson, 2009). Moreover, I aim to provide historical context for research on the initiatives that tackle the problems caused by tax havens, international tax evasion and corporate tax avoidance (Eden and Kudrle, 2005; Hasseldine and Morris, 2013; Murphy, 2007; Murphy, 2009; Preuss, 2010; Seabrooke and Wigan, 2013; Sharman, 2006; Sikka, 2010; Sikka, 2013; Spencer, 2014). Indeed, a common feature of many of these analyses has been that they discuss the growth of tax havens and corporate tax avoidance in the context of recent economic and financial globalization. Finally, the article contributes to the discussions about the epistemic communities, emergent entrepreneurs and the role of ideas and memory in the studies of international relations and international political economy.

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The demise of theoretical work on the societal powers of corporations in past decades has most likely reinforced these tendencies. Some inadequately resourced work conducted by UNCTAD notwithstanding, the UN had effectively withdrawn from working on the political and power aspects of TNCs in 1998. Moreover, the UN abandoned its work on the United Nations Code of Conduct on Transnational Corporations (CoC) in the early 1990s, rebuilding its work in this field with a less controversial angle on business and human rights in the late 1990s. Against this background, it is no surprise that the late 1990s and early 2000s saw a rediscovery of some of the initiatives developed in the 1970s, but this time in the context of human rights, good governance and anti-corruption efforts. It took the global financial crisis of 2007–2009 to push world leaders to gear up international policy work to a level distantly comparable with the UN efforts, but this time steered especially by the OECD. In addition to these findings, this article contributes also to the discussion on private global governance. I suggest that the International Accounting Standards Committee (IASC) has had an important role in providing an excuse for scaling down the UN work on regulation of international accounting.

This study draws on a large body of research. The material includes the key academic publications and UN policy documents from the late 1960s to the early 1980s. I selected the policy-related material by reviewing all the relevant material issued by the UN and the UNCTC and the reports and documents that preceded its creation. Not all UNCTC publications were used, as I focused the analysis on those reports with the most significance for the subject.<sup>2</sup> The documents were fetched from the website archive.org, as the UNCTC website (unctc.unctad.org) of UNCTAD was no longer operational. Finally, as background work for this article, I conducted semi-structured interviews of Klaus Sahlgren and Kari Tapiola in the summer of 2015<sup>3</sup> in Finland. Mr. Sahlgren was the first Executive Director of the UNCTC (1975–1983), and Mr. Tapiola was the Special Assistant to the Executive Director of the UNCTC (1976–1978).

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<sup>2</sup> The UNCTC published 265 documents during its existence (Hamdani and Ruffing, 2015: 49). There are necessarily gaps in the content of this article. However, enough information has been provided to establish a revelatory (Yin, 2003: 42) case study that provides enough material to question the earlier understanding of the phenomenon that is being researched.

<sup>3</sup> Sahlgren was interviewed in Korppoo and Tapiola in Helsinki.



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The early discussions on international tax avoidance and tax evasion emerged from three main sources in the late 1960s and during the 1970s. Of these, the most important were material produced by international agencies, especially the UN, as well as some notable work by the U.S. scholars. Moreover, these discussions were reflected in the domestic policy debates in the United States, such as the initiatives by the Kennedy administration and the hearings of the U.S. Senate on these topics (Rixen, 2010: 17; Webster, 1961). Since the 1910s, the international community had been addressing the phenomenon of double taxation in the League of Nations, the International Chamber of Commerce and other supranational bodies (Rixen, 2008: 88; Rixen, 2010). Only after the problem of double taxation had been at least somewhat resolved did the issue of undertaxation become relevant (Rixen, 2010: 4).

In the 1960s and 1970s, the most important policy initiatives focused on the accounting rules of TNCs and on model tax treaties. I start by presenting the organizational setting of the early attempts to develop an international anti-tax avoidance regime and then review the key discussions and materials produced by the UN organizations and the OECD. These documents were significant in providing far-reaching analyses of tax havens, tax avoidance and tax evasion, and in advocating various reforms to the international corporate tax systems, including the initiative for country-by-country reporting as well as the proposal for unitary taxation and discussion on automatic, multilateral exchange of information. All of these initiatives are currently discussed in various international bodies without proper awareness of their history. I contrast the early UN discussions with the aims of the OECD's BEPS project, as well as to the 1998 *Harmful Tax Practices* report. I argue that although the UN efforts related to regulating TNCs are relatively well known within the scholarship on development studies and global political economy studies, there has been a lack of substantial analysis of the UN proposals that would have benefited later research on tax avoidance and evasion.

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## 2. The organizational setting and the work on exchange of tax information

After heated and unsuccessful discussions in the UN's newly formed Economic and Social Council (ECOSOC), the post-World War II work on international taxation became an OECD-led initiative with an explicit focus on eliminating double taxation (Picciotto, 1992: 48–51; Rixen, 2008: 96–97). In contrast to the Keynesian mainstream of the time, the OECD generally advocated laissez-faire stances in much of its economic policy (Williams, 2008: 118). In 1956, the OECD's Fiscal Committee, made up of government officials and tax experts, began to elaborate a draft convention with the aim of providing solutions to the problem of double taxation among OECD member countries. The outcome of the Committee's work was adopted in July 1963 under the title *Draft Double Taxation Convention on Income and Capital*. While focusing on double-taxation issues, the convention also contained articles regarding the elimination of discriminatory tax provisions in internal laws and the reduction of international tax avoidance through the exchange of information between national tax administrations (Surrey, 1978a; Rixen, 2008).

In addition, the OECD also briefly addressed tax and development issues in its report titled *Fiscal Incentives for Private Investment in Developing Countries* (OECD, 1965). Although mostly faithful to its title, the report also noted how it is of major importance for a capital importing country to adopt provisions which would keep it from becoming a tax shelter for investors from industrialized countries. Moreover, the report highlighted the problems caused by round-tripping capital: capital that is first transferred out from and then back to the country of origin in order to gain tax benefits (OECD, 1965: 55). What is more, it also noted the importance of establishing tax treaties with developed countries (OECD, 1965: 58). However, the report did not provoke further research by the OECD at the time. With the exception of the OECD work on tax treaties, the UN soon took the lead in developing analyses of and initiatives against corporate tax avoidance and evasion.

The UN work occurred in two partially overlapping processes. The first originated from the Economic and Social Council's resolution 1273 (XLIII) in August 1967, which requested the Secretary-General to set up an ad hoc working group consisting of experts and tax

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administrators to explore ways and means for facilitating the conclusion of tax treaties between developed and developing countries. Made up of representatives nominated by governments, this working group published several reports in the 1970s. The second strand of the UN work arose from the UN efforts to regulate the operations of TNCs and was in part directed to addressing accounting issues. Establishing new international accounting standards was one of the priorities for dealing with the challenges created by TNCs. This process fed into the UN Code of Conduct on Transnational Corporations, which was negotiated for several years but finally abandoned in the early 1990s.

The Ad Hoc Group of Experts on Tax Treaties between Developed and Developing Countries was composed of 20 tax officials and experts nominated in their personal capacity.<sup>4</sup> The Group convened in 11 meetings from 1968 to 1977 to pursue the task of exploring ways and means for facilitating tax treaties between developing and developed countries “including the formulation, as appropriate, of possible guidelines and techniques for use in such tax treaties which would be acceptable to both groups of countries” (Economic and Social Council resolution 1273 (XLIII), August 1967, quoted in UN, 1979). Subsequently, in 1974, ECOSOC emitted a resolution stating that the provisions that the Group had been working on “could be standardized, with only a small number of clauses to be negotiated in particular cases, they would in fact amount to an international agreement on taxation, which ... [would be] the final objective”. The work then culminated in the draft model double-taxation treaty accompanied with a manual for implementation, first published in 1980. Based on this draft, the UN secretariat then produced the model convention that reproduced the Ad Hoc Group’s work, which itself was built partially on the double-tax convention that the OECD had produced (Surrey, 1978a).

By its resolution 1980/13 of 28 April 1980, ECOSOC renamed the Group of Experts as the Ad Hoc Group of Experts on International Cooperation in Tax Matters. After a period of inactivity, the group reconvened in 1997 and was renamed again in 2004 as the Committee of Experts on International Cooperation in Tax Matters – commonly

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<sup>4</sup> These countries were initially Argentina, Chile, France, Germany, Ghana, India, Israel, Japan, the Netherlands, Norway, Pakistan, the Philippines, the Sudan, Switzerland, Tunisia, Turkey, the United Kingdom and the United States. In later years, the membership varied and was expanded further.

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referred to as the UN tax committee (Rixen, 2008: 147–148; UN, 2002). Though inadequately resourced and relatively poorly known outside tax policy circles, the UN Tax Committee still updates the Model Tax Treaty. The UN version gives more taxing rights to source countries, whereas the OECD's treaty leans more towards the residence principle (Surrey, 1978a). In this way, the UN Model Treaty is more favourable for most of the developing countries. From early on, the Group stressed many of the concerns that are familiar from the contemporary debates (UN, 1969, 1970, 1972, 1973, 1975, 1976, 1978, 1979). Even though the group had a special focus on tax information exchange, it touched upon many other issues – from tax havens to transfer pricing, which was the special concern of the 1975 report (UN, 1975: 14).

At the July 1972 meeting of ECOSOC, the Chilean representative required the UN to appoint a high-ranking expert commission to study the role of multinational corporations (Rahman 1998: 595; Sagafi-Nejad et al., 2008: 43–47). The call was ignited by a 1971 U.S. Senate subcommittee report that confirmed the alleged involvement of the International Telegraph and Telephone Corporation (ITT) in destabilizing the democratic government of Salvador Allende in Chile (Rahman, 1998: 595; Sagafi-Nejad et al., 2008: 42–43; Hamdani and Ruffing, 2015). The ECOSOC resolution stated, “The international community has yet to formulate a positive policy and establish effective machinery for dealing with the issues raised by the activities of these corporations” (ECOSOC, 1972: 3). Hence, ECOSOC decided to appoint the 20-member Group of Eminent Persons (GEP) in 1972. The group included nine members from the public sector, six from academe, and five from public and private enterprises and on a broad geographical basis (Sagafi-Nejad et al., 2008: 57). The group was assigned to study the role of multinational corporations and their impact on the process of development (ECOSOC, 1972: 4). This marked the beginning of the other strand of the UN work on anti-tax avoidance initiatives.

The GEP finished its report in 1974 and recommended, among other things, that a Commission for Transnational Corporations and an Information and Research Centre on Transnational Corporations be established under ECOSOC (Rahman, 1998: 599; Hamdani and Ruffing,

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2015).<sup>5</sup> A year after the GEP report, in 1975, the UNCTC was formed as an autonomous centre of the UN Secretariat in New York, where it operated until 1993 (Sagafi-Nejad et al., 2008: 6; Sauvart, 2015). The UN Member States also decided to form several subgroups under the UNCTC. One of these subgroups was the UN group of accounting experts (GEISAR) that convened in 1976 (Rahman, 1998: 598).<sup>6</sup> It was the 1977 GEISAR report that moved the substantial accounting-related issues forward, although the group suffered from some organizational misfortunes (Yoshida, 1987: 258–259).<sup>7</sup> Although the UN's role in early attempts to establish international regulation of accounting has been noted in the literature on global economic governance (e.g. Nölke, 2011: 67; McSweeney, 2010: 10), these accounts have not analysed the UN's substantial contributions towards broader financial reporting (with the exceptions of Surrey, 1978a; Surrey, 1978b; and Hamdani and Ruffing, 2015). Owing to the strong emphasis on accounting issues, the GEISAR group made advances, especially in improving corporate financial transparency.

### **3. The UN contributions in analysing international corporate tax avoidance and its impacts**

This section looks at the substantial contributions of the various UNCTC groups and reports analysing international corporate tax avoidance and evasion, highlighting some of the key insights that the UNCTC documents provide on corporate tax avoidance and its effects. After this section, I turn to analyse thematically the key policy proposals and their contemporary significance. Generally, it can be said that the early UNCTC reports portrayed a surprisingly clairvoyant and even far-sighted analysis of the key loopholes in international corporate tax governance. This was especially valuable as the theme was severely underresearched at the time, which made the work of the rapporteurs highly challenging.

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<sup>5</sup> In 1973, the UN Department of Economic and Social Affairs prepared a background report, *Multinational Corporations in Development*, for the GEP. Many of the recommendations and analyses of the GEP drew heavily from this 1973 report (Sagafi-Nejad et al., 2008: 59).

<sup>6</sup> In addition, a Working Group on the Code of Conduct was created under the UNCTC (Sauvart, 2015: 20).

<sup>7</sup> Yoshida notes how the first report was not formally adopted because members of the Group were not government representatives of their respective countries.

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The GEP made several important contributions. In its 1974 report, it noted how “advances in communications technology allow many multinational corporations to pursue global strategies which, rather than maximizing the profits or growth of individual affiliates, seek to advance the interest of the enterprise as a whole” (UN, 1974: 30). These profit maximization strategies were helped by a “lack of harmonization of policies among countries, in monetary or tax fields for example”, which allows transnationally mobile multinational corporations to “circumvent national policies or render them ineffective” (UN, 1974: 30). This circumvention is usually conducted “by corporate planning mechanisms situated in a few industrial countries” (UN, 1974: 30), resulting in a situation where “the ‘invisible hand’ of the market is far from the only force guiding economic decisions” (UN, 1974: 41).

Furthermore, the GEP report stated that corporations could engage in price discrimination and (abusive) transfer pricing, among other market-distorting acts<sup>8</sup> (UN, 1974: 30). The report argued that “a policy framework which may be adequate for dealing with national corporations needs to be modified when dealing with multinational ones” (UN, 1974: 31), since national attempts to raise taxes “can be negated by vertically or horizontally integrated multinational corporations through transfer pricing and the use of tax havens” (UN, 1974: 35). This analysis on transfer pricing and tax havens was surprisingly mature, given that it was formulated in the mid-1970s. Although the GEP report identified some policy demands, its major policy contribution was to pave the way for further UN work on TNCs. In addition, it is worth noting that the report demanded larger taxing rights and help in tax-related capacity building for developing countries. And remarkably, both of these demands have been emerging issues in the financing for development discussions in the current millennium.

The 1974 GEP report was not the first UNCTC publication to highlight the significance of transfer pricing-related tax avoidance. A year earlier, the Multinational Corporations in World Development report addressed this issue at length. The report noted that the “large incidence of inter-affiliate transactions and attendant transfer pricing can distort the real picture, as can other practices involving

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<sup>8</sup> It should be noted that transfer pricing is a necessary feature of intracompany trade in any corporation. Transfer pricing can facilitate tax avoidance when the prices used in the intrafirm price are being distorted.

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capitalization, accounting procedures, and control of local resources”, and that this distortion takes place by charging prices for imports that are “far above prevailing ‘world’ prices, and [that] conversely those for exports have been below world prices” (UN, 1973: 32). The UNCTC also noted that many goods and service trades within firms do *not* involve arm’s length transactions. Hence, “their prices are not determined by the market mechanism but by the corporations themselves” (UN, 1973: 33). This resonates with the contemporary research on this issue (e.g. Avi-Yonah, 2004: 499, 1995; Eden, 2016; Ylönen and Teivainen, 2015).

Moreover, in response to a request by the UNCTAD Secretary-General, the 1972 report of the Ad Hoc Group of Experts on Tax Treaties between Developed and Developing Countries dedicated a chapter to addressing tax avoidance and evasion. These topics were addressed frequently in subsequent reports as well. The 1972 report noted the difficulties that developing countries face in auditing intrafirm transfer prices. In addition, the report noted how “international tax evasion was viewed as a serious problem by developing countries substantially engaged in world commerce” (UN, 1972: 54). Representatives of developing countries highlighted the problems created by tax avoidance, especially in relation to dividends and loans, as well as through “the use of favourable legal forms, tax havens, abuse of certain tax incentives, and tax treaties as vehicles for tax avoidance” (UN, 1972: 54). Finally, the 1979 Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries summarized much of the work of earlier reports (UN, 1979). As with many other UN publications on these themes, however, its substantial inputs were later forgotten.

The UN’s insights on corporate tax avoidance were not limited to the issue of transfer pricing. As an example, the 1976 UNCTC report that viewed corporate accounting and reporting issues from the developing country perspective drew attention to the problems of thin capitalization. The report noted that there are cases in which “capital expenditures by subsidiaries are financed by the parent company by means of loans at relatively high rates of interest rather than by an increase in the subsidiary’s equity” (UN, 1976: 4; see also Surrey, 1978b). Moreover, dividends and royalty payments can be used to withdraw profits from subsidiaries and by a careful utilization of holding companies (UN, 1973, 32; see also Surrey, 1978a: 32–41). In other words, the publications presented a fairly concise and detailed

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picture of tax avoidance practices, even though the information was scattered among several reports.

What is more, the UN reports offered a sophisticated analysis of the role of royalties in international tax avoidance. The 1973 report on the role of MNCs in world development noted how estimates of royalties can distort the true payments for know-how in various ways. In particular, the “distortion may take the form of overpricing of intermediate products and capital goods, which are tied to the imports of technology, or the underpricing of exports to the suppliers of the technical know-how” (UN, 1973: 50). As a consequence, changes in royalty payments may not reflect changes in real prices but simply “a readjustment in the distribution of returns among the different channels of income remission” (UN, 1973: 50). A UNCTC report published a year later stressed the importance of arbitrary pricing of services, patents or techniques of know-how in intrafirm trade (Shoup, 1974: 8). The 1976 report touched upon this same theme by noting how the key question in the pricing of overhead expenses is not one of pricing but of where the profits are the allocated – and that this allocation is often not fair (UN, 1976: 4).

#### **4. The UN proposals for reforming the international tax system: A contemporary angle**

This section looks at the substantial policy proposals made by the Ad Hoc Group of Experts on Tax Treaties between Developed and Developing Countries, the UNCTC, and its subgroups. The UNCTC’s work on accounting standards and the Code of Conduct on Transnational Corporations have already gathered scholarly attention (Hamdani and Ruffing, 2015); however, my approach differs markedly from earlier accounts. Specifically, I look at the UN’s and the UNCTC’s policy contributions in light of contemporary discussions on tackling international tax avoidance, especially in the context of the OECD’s 1998 *Harmful Tax Competition* initiative and the BEPS process. I begin with what seems to be one of the most obvious contributions, namely the work on exchange of information. After this, I continue by discussing the UN work on accounting standards. Here I highlight the so-far neglected aspect of GEISAR’s work, namely the proposals for increased country-level and segmented reporting that arose alongside similar developments in academia. Third, I highlight the UNCTC’s discussions



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on another contemporary, highly relevant initiative – unitary taxation. Finally, I cover some other initiatives that were mentioned in the UNCTC’s publications, such as the proposal for the International Tax Court and greater regional tax cooperation, an initiative that is currently being debated, for example, in the African Tax Administrators Forum.

Already in 1969, the Ad Hoc Group of Experts on Tax Treaties between Developed and Developing Countries had noted how developing countries may not benefit from the tax information exchange agreements (UN, 1969: 19). This led the Group to demand stronger wording on the exchange of information than in the OECD’s approach, with a special emphasis on preventing fraud and tax evasion, and stress on the affirmative obligation of competent authorities to fully implement the exchange of information (Surrey, 1978a: 4). In 1971, the issue of automatic exchange of information was brought up in the Group, as well as the obstacles created by banking secrecy laws and the use of holding companies. Specifically, the Group noted how “exchanges of information between tax administrations through the application of tax agreements, could not be regarded as a very effective method of putting an end to the flight of capital, and more comprehensive international co-operation was therefore required in that field” (UN, 1970: 19). A year later, multilateral exchange of information was highlighted as a possible solution to these problems (UN, 1972: 55), although the Group report published six years later found this idea to be “premature” (UN, 1978: 59). Nearly four decades later, multilateral exchange of information has finally made a breakthrough in global governance, with several recent initiatives put forward by the OECD, the European Union (EU) and the G20.

Building on the aforementioned analyses in the 1974 Report of the Eminent Persons, the GEISAR group was the main forum at which the UNCTC developed its inputs for international accounting regulation. The first GEISAR report noted that traditional annual reports are oriented to the information needs of shareholders and creditors and that there is a need for broader, improved, and more harmonized corporate reporting (UN, 1977: 2). The report also made a detailed proposal for the items that should be furnished in the future accounting standards. The proposal included a section on Financial information on members of a transnational corporation group (UN, 1977: 20) and another section on Reporting on segments of a transnational corporation (UN, 1977: 21).

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The following information was proposed for reporting under the first category (UN, 1977, Annex p. 8):

1. List of significant subsidiaries and percentage ownership (by geographical area of operation), justify exclusion of any such subsidiaries from consolidation. Carry excluded subsidiaries at equity or disclose equity in the footnotes.

2. List of associated companies and nature of relationship with parent company (by geographical area of operation). Justify carrying such investments at other than equity and disclose equity in the footnotes.

3. Disclosure of identity of parent company in reports of subsidiaries.

4. Disclosure of information on the following (eliminated in consolidated statements)

(a) Intercompany sales

(b) Intercompany charges for interest, royalties, license fees, rental for use of tangible property and other intangibles

(c) Intercompany charges for research and development, advertising, management services and other allocated expenses

(d) Net increase (decrease) in intercompany investments

(e) Net increase (decrease) in intercompany loans

In addition, the GEISAR report demanded segmented reporting for assets or net assets, revenues, earnings, exposure to exceptional risks, principal activities in each area, new capital investments, identifiable assets by industries, other assets, revenue and sales by industries, and one or more of the following: profit contribution, operating profit, profit before taxes and net profit. Effectively, these measures would have resulted in a significant broadening of the corporate reporting requirements.

Similar issues were also discussed in the OECD, but with less ambitious formulations. The 1976 OECD Guidelines for Multinational Enterprises stated that companies should publish annually the structure

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of the enterprise, the geographical areas where the company operates, sales by geographic area and by major lines of business, significant new capital investments, the sources and uses of funds of the company as a whole, the average number of employees and the R&D expenditures in each geographical area, the policies followed for intragroup pricing and the accounting policies (Surrey, 1978b: 434–435). Interestingly, the OECD’s 1976 Guidelines also stated that companies should “refrain from making use of the particular facilities available to them, such as transfer pricing which does not conform to an arm’s length standard” (Surrey, 1978b: 437).<sup>9</sup>

The OECD’s early contribution to the tax and corporate responsibility discussions is a notable opening, especially as this theme has started to attract scholarly attention only in recent years (Hasseldine and Morris, 2013; Sikka, 2010; Sikka, 2013; Ylönen and Laine, 2015). However, in contrast to the UN’s guidelines, the OECD’s contributions were designed to remain voluntary. Although there was a consensus that the UN’s Code of Conduct was to be not compulsory in character by that time either, the GEP believed that the authority of the international organizations and the pressure from the public would help to realize their aims (UN, 1974b: 55). In addition, the long-term goal was to come up with a “general agreement on multinational corporations having a force of an international treaty and containing provisions for machinery and sanctions” (Hamdani and Ruffing, 2015: 80). The work of the GEISAR group continued in several subsequent reports. In the 1980 interim report, the group noted,

Transnational corporations should make available to the public in the countries in which they operate clear, full and comprehensible information designed to improve understanding of the structure, activities, and policies of the transnational corporation as a whole. The information should include financial as well as non-financial items and should be made available on a regular annual basis ... information provided for the transnational corporation as a whole should be broken down by geographical

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<sup>9</sup> In the 2000 update of the OECD’s Guidelines, this point had been modified to suggest that companies should comply with the tax laws and regulations by conforming transfer pricing practices to the arm’s length principle (OECD, 2001: 135). The same formulation is repeated in the most recent 2011 version of the OECD’s guidelines (OECD, 2011).

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area or country, as appropriate, with regard to activities of its entities, sales, operating results and significant new investment; and by major line of business. (UN, 1980, Annex III)

Finally, the GEISAR reports contributed to the draft versions of the CoC, and drafting the CoC was the established highest-priority task of the UNCTC. They were submitted to the UNCTC at its eighth session in 1982. The negotiations were entrusted to a special session of the Commission that began deliberations in 1983 and was open to the participation of all Member States (UN, 1983). The 1983 draft noted that “transnational corporations shall/should carry on their activities in conformity with the development policies, objectives and priorities set out by the Governments of the countries in which they operate” (para 9). Moreover, the draft CoC also had subsections dedicated to transfer pricing and corporate taxation. On the latter issue, the document stated that corporations should/shall not “use their corporate structure and modes of operation, such as the use of intra-corporate pricing which is not based on the arm’s length principle, or other means, to modify the tax base on which their entities are assessed” (para 34). Finally, the draft document also noted that “in respect of their intra-corporate transactions, transnational corporations, should/shall not use pricing policies that are not based on relevant market prices, or, in the absence of such prices, the arm’s length principle, which have the effect of modifying the tax base on which their entities are assessed or of evading exchange control measures [or customs valuation regulations] [or which [contrary to national laws and regulations] adversely affect economic and social conditions] of the countries in which they operate” (UN, 1983, para 33, brackets in the original negotiation’s draft text).

These words ended up being the most important demands of the UN machinery for tackling corporate tax flight. Then the atmosphere changed. As a symptom of this, GEISAR switched to a more cautious tone in its analysis in 1984, and its mission was significantly narrowed. Instead of pursuing the development of new accounting standards, the group’s mandate changed “to review material from international accountancy bodies and other interested groups” (UN, 1984: 3). According to Rahman (1998), this reflected the increased prominence of the self-regulatory IASC as the main body for discussions on regulation of international accounting. In addition, the group “considered it necessary to take account of the need of transnational corporations to

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maintain business confidentiality in sensitive areas, in particular so as not to jeopardize their competitive position” (UN, 1984: 5). The goal was then revised; international harmonization was now the long-term objective (UN, 1984: 5). As Hamdani and Ruffing (2015: 80) note, the “proponents overreached for a general agreement and failed in their primary task to complete a code of conduct”.

The new rhetoric resonated well with the concerns that some delegations already had with the first GEISAR report, which they called “overly ambitious” (UN, 1984: 5). The ambition level was significantly reduced as a distinction was made between general purpose and special purpose reporting. Public disclosure of special purpose reporting might be permitted only by mutual agreement instead of mandatory requirement (UN, 1984: 5). Finally, in 1988, the UN released its conclusions on accounting and reporting by TNCs (UN, 1988). Although the conclusions still included many of the ideas from the first GEISAR report, it became clear that the UN had been sidelined in the discussions on international accounting regulation (Hamdani and Ruffing 2015: 18). The group was ultimately unable to ratify an agreeable code owing to various disagreements between developed and developing countries, and the group was finally dissolved in 1994, after the abolition of the UNCTC in 1992 (Deva, 2012; Hamdani and Ruffing, 2015). Chapter X of the 1993 *World Investment Report* (UN 1993) ended up being one of the last manifestations of the old UN paradigm, in regard to its analyses of the possibilities of unitary taxation and the use of advance pricing agreements for fixing the underlying problems of the arm’s length principle.<sup>10</sup> Eventually, public pressures led the UN to re-establish its work on TNCs in the late 1990s, but this time in the much less controversial context of business and human rights.

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<sup>10</sup> Most of the other *World Investment Reports* published during the 1990s and 2000s analysed the growth and development of bilateral tax treaties, occasionally also discussing issues related to e.g. tax havens and intrafirm tax avoidance. Illustratively, in 2000, the report noted how “Concern about transfer pricing, greatest in the 1960s and 1970s, has declined as tax differences have narrowed, double-taxation agreements have proliferated and the desire to attract FDI has become widespread” (UN, 2000: 165). The *World Investment Report 2005* was the first not to explicitly mention the UNCTC in its foreword note, referring instead to the UN’s 30 years of experience in these areas (UN, 2005: ii). Recently, interest in these themes has regenerated; e.g. the 2015 *World Investment Report* included a chapter dedicated to international tax and investment policy coherence (UN, 2015).

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The initiatives originally put forward by GEISAR and some academics (especially Ralph Nader, Mark Green and Joseph Seligman, who explicitly discussed country-by-country reporting in the 1970s<sup>11</sup>) bore great resemblance to the country-by-country reporting initiatives (Murphy, 2007; Murphy, 2009) that have been developed in the current millennium. Both strands of initiatives call for similar extensions in corporate transparency and share an analysis of the problems created by the lack of disclosure. Moreover, they proposed similar measures for addressing these problems. Recently, the extended country-by-country reporting requirements for TNCs have been praised as the single most important outcome of the BEPS project – even though the reports will be accessible only for authorities and the new system will not be accompanied by an effective exchange of information on the reports (BEPS Monitoring Group, 2015).

Unitary taxation is another major corporate tax-related initiative that has been discussed for a long time, recently for example in the EU. Basically, unitary taxation presents a competing principle to the prevailing arm's length principle in the regulation of intracompany trade. In contrast to the arm's length principle, which treats subsidiaries of a TNC as separate entities, unitary taxation taxes companies as a single entity, with tax revenues distributed to states by a commonly agreed formula (Eden, 2007: 612; see also Avi-Yonah, 2016). This kind of system is used in the United States for allocating tax revenues between the individual states. The EU had already presented a first draft for its so-called Common Consolidated Corporate Tax Base (CCCTB) in 2011 (European Commission, 2011), and in June 2015 the European Commission included the CCCTB as a central goal in its five-point action plan on corporate taxation (European Commission, 2015).

The EU was not the first organization by far to discuss unitary taxation. Indeed, the initiative was brought up in the negotiations of the League of Nations, but it was found too politically difficult to adopt. The discussions in the UNCTC should also be highlighted. For example, the UNCTC's 1974 technical paper on taxation noted how

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<sup>11</sup> Specifically, Nader et al. (1977) maintained that trade secrecy had become an all-purpose excuse for declining an information request, even though the actual trade secrecy privilege is quite narrow (p. 138). Moreover, they suggested that statements should be broken down on a 'U.S.' and 'all foreign' basis, and that there should be foreign financial reports furnished on a country-by-country basis (p. 176).

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“a radical change in the taxation of multinational corporation profits would be the adoption of a factor-formula technique” (Shoup, 1974: 33). Another contributor of this publication also noted how an “implicit justification for formula apportionment is essentially that profits should be apportioned among the states in proportion to the contribution to the value added” (McLure Jr., 1974: 69).

Unitary taxation was also discussed in the 1974 Report of the Eminent Persons. Noting the existing unitary taxation practice in the United States, the report suggested that an agreed pro rata formula would be an ambitious approach to tax TNCs (p. 93). Moreover, the authors of the report noted that taxing the worldwide profits on an accrual basis would help in tackling tax havens. The report even discussed the possibility of denying the right of establishment in countries that would not adhere to the unitary system (UN, 1974: 93). Although unitary taxation never found its way into the policy proposals of GEISAR and the discussion in the GEP report was also non-confirmative, it is clear that the major UNCTC bodies understood the potential of the initiative (UN 1974, pp. 93–94) .

Finally, the UNCTC publications covered some lesser-known initiatives that have been rediscovered in the past years. As a one significant example, the 1974 Report of Eminent Persons called the governments to “disclose the principal terms of agreements between them and multinational corporations” (p. 96), a call that has been raised several times after the LuxLeaks scandal, which involved some 30,000 tax-related pricing agreements that the government of Luxembourg had conducted with multinational companies. Moreover, recent years have seen several calls and attempts for increased South-South cooperation in international tax matters. The need for and potential benefits of this kind of cooperation had already been noticed in the 1974 Report of the Eminent Persons (UN, 1974). Finally, the 1974 technical paper on taxation also discussed the possibility of “setting up an international tax court...to obviate intercountry inconsistencies in transfer pricing” (Shoup, 1974: 32), resembling discussions on an independent dispute-settlement body or arbitration mechanism in recent proposals for a new international tax authority (Rixen, 2016; Tanzi, 2016). The list could be continued.

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All in all, the tax initiatives that the UNCTC advocated either directly through its conduct or more indecisively in its reports have proven to be surprisingly relevant even today. The automatic exchange of tax information has progressed quickly in the post-financial crisis era. The country-specific and sector-specific financial reporting for corporations was extended first in the early 2000s with voluntary initiatives in the extractive industries, and then with mandatory legislation in the financial sector and extractive industries. Moreover, the OECD's BEPS process introduced mandatory country-by-country reporting for TNCs in all sectors, even though this information will not be public and therefore it remains to be seen how well the information exchange between countries on this information will work. Many of the other overall concerns discussed in the UNCTC remain also highly relevant.

## **5. Looking back: why were the UNCTC's proposals forgotten?**

In recent decades, the constructivist turn in international relations and other social sciences has drawn much attention to the role of ideas in shaping politics on all levels. Robert Cox (1983, 1986), Keck and Sikkink (1999), and many others scholars have made a strong case that policy experts, the transnational classes that they form and the ideas they convey have a much bigger impact on world politics than had been commonly understood earlier. The collective amnesia about the UN's early work in the field of international corporate taxation is a prime example of this. The oblivion of the proposals that the UN (and to a lesser extent the OECD) advocated for between 1960s and 1980s not only made rediscovering many of these initiatives a painful and prolonged process, but also facilitated the emergence of alternative conceptual frameworks for understanding the role of large corporations in the society. The OECD-driven late-1990s tax community (Haas, 1992) failed to pay attention to the earlier work of the UN, which paved the way for the OECD's triumphant re-entry in this field in the late 1990s.

The 1990s saw the parallel emergence of the corporate social responsibility agenda and the OECD's work on tax havens. These initiatives represented a comeback of calls for better regulation and transparency of TNCs, but in a form that had little in common with the earlier UN efforts. The UN had restarted its own work on corporations,



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as the Sub-Commission on the Promotion and Protection of Human Rights founded a Working Group on Transnational Corporations in 1998. Three years later, the Group completed the final draft of the Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights, which served as a basis for the United Nations Guiding Principles on Business and Human Rights. Commonly known as the Ruggie principles, their approach to TNCs was based on the concept of corporate responsibilities, which resonated well with the rising corporate social responsibility agenda of the time. Importantly, many of the civil society organizations criticizing the dominant world powers also embraced the human rights and anti-corruption agendas. In the early 2000s, the multi-stakeholder Extractive Industry Transparency Initiative gathered much attention with its rather modest anti-corruption aim of demanding greater voluntary transparency regarding payments to governments. A few years before this, a group of non-governmental organizations formed the Publish What You Pay initiative with a similar agenda (Seabrooke and Wigan, 2015). The norms of the time had become so widely shared that they were internalized by actors and achieved a taken for granted quality and conformity, which is a powerful building block for ideational power (Finnemore and Sikkink, 1998: 904).

Earlier I noted how the OECD's landmark report *Harmful Tax Practices: An Emerging Global Issue* (OECD, 1998) failed to cite any reference published before the early 1980s. In subsequent years, several scholars started to analyse the initiative (e.g. Dietsch, 2016; Meinzer, 2016; Sharman, 2006), but mostly from a contemporary angle. By the late 1990s the earlier UN agenda had been discarded on all fronts. In the field of accounting regulation, the IASC was formed in 1973 and the OECD geared up its work on accounting and international taxation (see below). Even though it has been argued that until the 1980s, the IASC "remained an obscure body with little impact on international accounting" (Martinez-Dias, 2005: 1), it seems plausible that its foundation strengthened the calls to scale down the accounting-related work of GEISAR and the UNCTC (Hamdani and Ruffing 2015: 133–136). As mentioned earlier, in 1984 the GEISAR group's mandate was reduced "to review material from international accountancy bodies and other interested groups" (UN, 1984: 3). At that time, the IASC was the only other international accountancy body. Thus, the IASC's importance has been larger than sometimes perceived right from its beginnings.

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This development is a prime example of forum shifting, which refers to a tendency of prevailing superpowers to shift discussions from one forum to another to avoid resistance and losses in forums that they do not adequately control (Braithwaite and Drahos, 2000: 28–29).

After the creation of the IASC, there was no room left for genuinely influential policy work for the UNCTC, as the major players in international politics backed the IASC. In a way, the UN became a victim of its own success, as its major progress was achieved in the field of accounting regulation. Little was left after the mandate to work on accounting issues was taken away from the UN. The IASC's successor, the International Accounting Standards Board (IASB), has been at least as disinclined to initiatives that would enhance corporate financial transparency as the IASC was (Lesage and Kaçar, 2013). Contrary to the situation in the 1970s and 1980s, however, one self-regulatory organization can no longer dominate the discussions on international accounting regulation, not even with a mandate that greatly exceeds that of the IASC. At the same time, the mainstream of academic studies on corporations shifted from analyses of power to more apolitical theories arising from transaction costs theory and conducted within econometric methods. After all, many of the UNCTC's analyses were either drafted by prominent academic researchers of the time or heavily influenced by them. Consequently, as the international policy community rediscovered the powers exerted by TNCs in the late 1990s, neither analytical tools nor policy networks were available for analysing them.

Moreover, the OECD also geared up its work on international tax issues in tandem with the forum shift from the UN to the IASC. In 1975, the OECD established the Committee on International Investment and Multinational Enterprises, “almost certainly in response to the adversarial attitude of many countries to TNC activities” (Sagafi-Nejad et al., 2008: 111). One of the tasks of this committee was to elaborate its own set of guidelines – adopted in June 1975 – a move that was at least partly targeted against the UN process of 1976 (Hamdani and Ruffing, 2015: 83). Moreover, the International Labour Organization also started a similar initiative for creating its own guidelines for TNCs (Tapiola, 2015: 110). And as the pressure coming from the UNCTC faded, the OECD's earlier views on including transfer-pricing issues in the scope of corporate code of conduct were also forgotten.

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In addition, the conclusion of bilateral tax treaties for the elimination of double taxation emerged from the 1960s onward as a salient feature of inter-State relations (UN, 2003: 3; see also Hearson, 2015). Earlier I noted that the OECD published its first draft model treaty for bilateral treaties in 1963 and that finally the OECD Model Double Tax Convention on Income and on Capital was published in 1977 (UN, 2003: 3). The rules for dividing corporate tax incomes between states were thus developed in the same period that the UN was discussing the rules for financial disclosure of these activities, thus downplaying the UN activities. Even though the OECD had recognized some of the developing-country concerns as early as in 1965, the OECD's solutions were clearly more favourable to the developed countries. Altogether, these factors helped the OECD to secure its leading position in what has been called the international tax regime (Eden, 2007: 598).

Last but definitely not least, several developments in the global political economy favoured the demise of the UN and the UNCTC and the shift to less ambitious forums. Sagafi-Nejad et al. (2008: 119) noted that by "the mid-1980s, many developing countries were in the throes of structural adjustment policies to cope with deficits in their balance of payments, the aftermath of recession, and the huge debts that arose from the energy crises of 1973-1974 and 1979-1980" (see also Hamdani and Ruffing, 2015: 18). Consequently, developing countries were desperate for capital and technology. This led many countries to revise their attitudes toward TNCs, either voluntarily or forced by the structural adjustment programs. The UNCTC was dissolved in 1993, with its remaining functions integrated into UNCTAD. Sagafi-Nejad et al. (2008: 29) described how "nation-states became friendlier towards FDI, competing over who would give more generous incentives to attract companies". Consequently, the focus of the UN shifted. The emphasis on a code of conduct, not to speak of a more binding version of it in the future, which were the key goals of the UNCTC, were de-prioritized and eventually faded into oblivion.

After the UNCTC was dismantled, UNCTAD occasionally touched upon tax and accounting issues in some of its seminars, mostly from the perspective of capacity building for developing countries (Sagafi-Nejad *et al.*, 2008: 137). Although the UNCTC's work on accounting continued to receive some coverage (e.g. Cobham and McNair, 2012: 44), the early UNCTC proposals were largely forgotten. In addition,

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the poorly resourced UN Tax Committee has never managed to become a serious competitor to the OECD, despite the interest by civil society in stepping up its resources and mandate in the 2000s. In this millennium, civil society organizations such as the Tax Justice Network and Global Financial Integrity have had a central role in promoting initiatives such as automatic exchange of information and country-by-country reporting. However, generally they seem to have had a more contemporary orientation to these issues (Seabrooke, 2014: 50). In this decade, however, tax-related themes have made a real breakthrough onto the international policy agenda in UN and other forums (e.g., UN 2015).

The experience of the UN and the OECD in tackling international corporate tax avoidance highlights the interlinkages between so-called epistemic communities that include the key policymakers in one policy area, and their collective memory. Langenbacher (2010: 33) has noted how power stems from the degree of dominance that a memory achieves in a political culture and the importance of how many memories circulate, how widely a specific memory is held and how deep the attachment is.<sup>12</sup> In the late 1990s, the memories circulating about the earlier UN work were few and far between. The backgrounds and shared knowledge of the emergent entrepreneurs (Seabrooke and Wigan, 2013) who have recently promoted these issues in civil society and international organizations differed markedly from that of the specialists whose knowledge the UN had employed in the 1970s. However, it would be misguided to see this shift as necessarily a negative thing. Although the collective oblivion helped the OECD to gather publicity for its 1998 Harmful Tax Competition report and its newborn role in this field, it may have also helped critics of the OECD to attach a sense of novelty to policy ideas that went beyond those advocated by the OECD.

In summary, the project for regulating corporate planning and bring more transparency to it in the 1970s was institutionally conducted in a winner-takes-all situation. The UN made major headway with the work conducted in the Ad Hoc Group, the UNCTC and its GEISAR group,

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<sup>12</sup> Langenbacher and Shain have also noted how the international policy impact of collective memory has not received the systematic attention in either the academy or the policy arena that it deserves (2010: 1). It is easy to agree with this statement in light of the case studies put forward in this article.

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but its influence faded as the balance of power shifted in favour of the IASC and the OECD. These developments were accentuated by the lack of additional forces (civil society, media, and other international organizations) that would have been able to sustain the pressure. Recalling how the transnational legal order on international corporate taxation developed in the 1920s as an expert-driven process with only a limited global political interest (Genschel and Rixen, 2014), it can be seen that the 1970s permitted the birth of a similar exercise in the epistemic community (Braithwaite and Drahos, 2000; Haas, 1992) of corporate tax avoidance experts. However, compared with the 1920s, this consolidation period was a short one, as the OECD and other competing organizations started to challenge the UN position. This is an important reminder that even if the emergent entrepreneurs manage to seize the moment with ideas well suited to the political moods of the time, a sudden shift in the international balance of power can quickly derail such attempts.

In comparison, today's emergent entrepreneurs benefit from the fact that the current international political situation is much more diverse with regard to both ideas and institutions. This enables civil society organizations, international organizations, politicians and even investors to gain small but repeated political victories in pushing initiatives against tax avoidance and tax havens despite powerful resistance from the IASB and elsewhere. The disempowering and consequent dismantling of the UNCTC and parts of the other UN work resulted in the destruction of a policy community – or epistemic community – that could have maintained and spread knowledge of the ways to open up corporate accounts (Braithwaite and Drahos, 2000: 29). The epistemic community of accounting companies was strengthened instead.

The example of the development of broader disclosure requirements in the UNCTC and the calls for other ways to tackle tax flight and tax havens show how difficult it is to create a lasting political initiative when its success depends on the political will and resources of a single international organization under constant threat of losing its legitimacy in the eyes of the prevailing powers. The results of the UNCTC's loss of legitimacy and power, coupled with the ideological turn of the late 1970s and the U.S. Senate's loss of interest in researching the political power of the corporation were so devastating that the

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substantial inputs proposed by the UNCTC and the scholars of that time seem to have been forgotten by academe, policymakers, and civil society. In contrast, compared with the 1970s, there is a much broader consensus today between northern and southern countries on the issues and problems at stake. Therefore, playing down the proposed initiatives is and likely will be more difficult for their opponents than in the earlier decades.

Despite their eventual failure, the early UN proposals were surprisingly clairvoyant in their analysis of the problem at hand and the policy measures the UN proposed. One key reason for this was probably that the UNCTC put great effort into recruiting the best-skilled people available for drafting the substantial material. Many of these people were from academia and were hired on a consultancy basis, in case they were unwilling to sign a longer contract or the UNCTC was unable to afford them (interview with Klaus Sahlgren). This situation can be contrasted with the corporate transparency initiatives developed from the beginning of the 1990s onward. A big difference between these two historical waves in calls for corporate transparency was in their underlying analysis of corporate power. The early proposals for corporate financial transparency saw the corporate planning as a major problem for the functioning of markets and well-functioning state governance. In contrast, the 1990s calls for corporate transparency were framed more in the context of corporate social responsibility and tackling of corruption. In this sense, they were partly products of the anti-state tenets of the 1980s that played a role in the abandonment of the earlier initiatives.

## **6. Final words**

In August 2015, policymakers, civil society, and UN personnel from around the world gathered in Addis Ababa, Ethiopia, for the Third International Conference on Financing for Development. Preceded by the high-profile Monterrey conference in 2002 and the follow-up conference in Doha in 2008, the Addis Ababa event sought to renew international commitments for development financing in a difficult global political environment. One of the key goals of civil society representatives was to strengthen and upgrade the UN Tax Committee. However, the calls for more inclusive global governance of tax issues were not answered. In a way, history is repeating itself. The urge to

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reverse the forum shift that the IASC and the OECD managed in the 1970s is there, but the opposing forces have been too strong, at least for the time being.

A better understanding of the history of international tax governance may help in formulating better strategies and substantial arguments. This article has contributed to the political economy literature on corporate transparency and power in six respects. First, it provided new information on and analysis of the early history of the anti-tax avoidance and evasion initiatives, thus contributing to and in parts challenging some earlier accounts on this topic: as examples, I showed how the histories of the automatic exchange of information and country-by-country reporting initiatives – both key topics in the recent tax policy agenda – are longer than has been thought. Second, it demonstrated how the early UN publications discussed also other issues of contemporary relevance, such as South-South tax cooperation. Third, it hinted that we should look further back to understand also the emergence of the IASC, whose early significance may not have been sufficiently understood. Fourth, it highlighted that amidst the pressure from the UN, even the OECD promoted some far-reaching stances in linking tax payment with corporate social responsibility.

Fifth, the article suggested that the 1970s analyses of corporate tax avoidance drew also from the rich academic discussions of the time on corporate planning. Sixth, it showed that the examples put forward in this article can be helpful in illustrating the role of epistemic communities, emergent entrepreneurs and the politics of memory in recent social scientific research. This last may have been one explanation for why the policy community of the time was able to develop far-sighted analyses of and policy proposals for tackling corporate tax avoidance some 30 years before the contemporary discussions on these topics began.

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# Tax-driven wealth chains: A multiple case study of tax avoidance in the Finnish mining sector



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## ABSTRACT

This paper contributes to recent discussions of corporate tax avoidance and global wealth chains. Drawing on multiple case studies, we outline the key strategies adopted by Finnish mining companies as they seek to lower their tax burden. After screening the accounts of the companies mining metallic ores in Finland, we provide an in-depth analysis of the tax avoidance arrangements at three of these mines. The mines were operated by two Canadian enterprises that utilized seven different tax avoidance arrangements. The multiple case study approach adopted in this paper is helpful in developing both quantitative and qualitative tax avoidance research, since our findings highlight major deficiencies of datasets commonly used in the dominant quantitative tax avoidance research. Our qualitative approach helps tackle some of the limitations imposed on tax researchers as a result of the considerable secrecy surrounding tax matters. In particular, we argue that the existing tax avoidance research has focused too much on statutory corporate income tax rates even though today, tax minimization relies mostly on specific tax incentives and other loopholes in tax laws. We argue that the arrangements we describe mirror a wider phenomenon where multinational enterprises exert societal power commonly associated with sovereign states. Crossing the disciplinary boundaries of accounting, political economy and tax law, we also contribute to the emerging research agenda on global wealth chains. We call for more attention to the intersections between accounting and tax law for understanding how enterprises can separate their value chains from the intra-firm flows of wealth.

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## 1. Introduction

The system of prices is like the system of words or the system of numbers. Words, prices and numbers are nominal and not real. They are signs and symbols needed for the operation of working rules. . . . Words are deceptive if they do not convey the meaning intended; numbers are liars if they do not indicate the actual quantities; prices are inflated or deflated if they do not reflect the course of real value.

– John C. Commons, *Legal Foundations of Capitalism*, 1957 [1924]: 9

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Corporate tax avoidance is an emerging academic topic (e.g., Dallyn, *in press*; Jenkins & Newell, 2013: 381; Sikka & Willmott, 2010; Sikka, *in press*).<sup>1</sup> Tax has long been marginalized in political science, law, and social policy, and it has not received the 'intellectual attention it deserves from accounting scholars' (Boden, Killian, Mulligan, & Oats, 2010: 541–544). This obscurity has gradually changed. Tax avoidance has gathered increasing attention in academia, among inter- and non-governmental organizations and the media (for example Oxfam, 2016). Tax policies are no longer an isolated enclave within enterprises; rather, they are discussed 'in the boardroom' (KPMG, 2005). These tensions have resulted in calls for research of 'transfer pricing in broader social, political and organizational contexts' in order to understand how accounting techniques re-allocate wealth (Sikka & Willmott, 2010: 353).

This, however, is easier said than done. Graham and Tucker (2006: 2, 22) note that 'information about tax shelters is notoriously hard to find', suggesting that scholars should 'creatively obviate this lack of information' in order to understand tax shelters better (Lisowsky, 2010). Hanlon and Heitzman (2010: 157) also suggest the use of 'some other' data sources. We answer to these calls by providing a multiple case study (Yin, 2003) of mining industry tax planning. Cognizant that enterprises in most major mining countries are not obliged to disclose financial accounts of their subsidiaries, we turned our attention to thin capitalization related tax avoidance in an extractive-rich country where local financial accounts were available – Finland. The Finnish mining industry has developed significantly in the past decade, while still being of a reasonable size for an industry-wide analysis (see Section 3.2). In addition, Finland is a member of the EU and the OECD, and its corporate income taxation system is similar to most countries (see Section 3.2). Therefore, the findings can be used to assess the deficiencies of the global tax system in general. Moreover, our analysis on three different thin capitalization structures can be useful, not only in understanding the specific rules are needed to tackle them, but also in illustrating the underlying problems in the current international corporate taxation regime.

The literature on corporate tax avoidance has typically relied on two categories: intra-firm transfer pricing and thin capitalization (e.g., Becker, Fuest, & Riedel, 2012). These categories are occasionally supplemented by a third category of intellectual property rights (IPR) related tax avoidance (e.g., Corrick, 2016; Dischinger & Riedel, 2011). Of these, thin capitalization is typically understood as a practice whereby subsidiaries based in low-tax countries grant loans to subsidiaries in high-tax countries where the interest costs are tax-deductible (Becker et al., 2012; Buettner & Wamser, 2007; Bartelsman & Beetsma, 2003; Clausing, 2003; Desai, Foley, & Hines, 2005). For reasons discussed later, for the most part multinationals can select their capital structure in each country independent of the external funding needs of individual investments (Ting, 2014). Furthermore, IPR-related tax avoidance is usually discussed in the context of patents, copyrights and other products of the knowledge economy (e.g., Dischinger & Riedel, 2011). We contrast these generalizations by analyzing seven different types of tax avoidance arrangements we discovered in our case studies. In addition to thin capitalization we also discuss other arrangements such as the use of immaterial mining concessions in tax planning. This is the first contribution of this article.

Second, and related to the previous point, we argue that a better understanding of the cash flows and profit shifting arrangements can be helpful in developing the research methodologies that assess the effects of corporate tax avoidance. Since the mid-1990s, a lacunae of statistical research has emerged focusing on the factors and drivers of corporate tax planning. Based on the findings from our case studies, we maintain that many of the approaches and variables typically employed by econometric studies on corporate tax avoidance are too straightforward. As for an example, the statutory corporate income tax rates – a very common variable in the statistical research on corporate tax avoidance – play very little role in our case studies. We found that the low tax rates derived largely from specific tax incentives and questionable advance tax rulings while statutory tax rates had only a minimal role. The LuxLeaks tax deals (Marian, 2016a) and multiple famous cases discussed in the media related to American technology corporations such as Apple have previously highlighted this phenomena (European Commission, 2016a; Vleggeert, 2016). Many academics and the OECD (2015a) have also noted that the data used in quantitative tax avoidance studies is poor, which seriously impacts its use in the analysis of tax avoidance. We are able to tackle this problem by using multiple data sources and show that the databases used in econometric studies do not include the tax avoidance structures we discover. We discuss the deficiencies of quantitative tax avoidance research more in Section 2.1.

Third, drawing from the tradition of evolutionary economics as well as from contemporary research on the global political economy, we maintain that much world trade has little to do with market mechanisms as the prices are planned in corporate headquarters (Ylönen & Teivainen, 2015). The dominant quantitative approach in tax research offers few tools for analyzing this phenomenon because it operates on an aggregate statistical level, thus framing the phenomenon in a way that provides little information on the specifics of tax avoidance policies. We criticize some of the taken-for-granted assumptions behind the existing studies (Golden-Bibb & Locke, 2007: 6) and provide suggestions on how to improve their research methodologies. Contributing to the nascent literature on wealth chains, we argue that the artificial corporate price planning mechanisms thrive on two pillars of the international tax system, namely the separate entity doctrine and the arm's length principle. According to these principles, individual companies belonging to the same group are separately liable for their taxes and use of the arm's length prices in their mutual transactions. The separate entity doctrine not only facilitates tax

<sup>1</sup> When using concepts such as 'tax avoidance' or 'tax planning', we do not judge the legality of the arrangements, since aggressive tax planning structures are often legal (OECD, 2013). The national tax authorities and ultimately courts assess the legality of certain arrangements based on local legislation, obtaining also confidential corporate information not available for research purposes (for further discussion, see for example Otusanya, 2011).



avoidance arrangements (Eden & Kudrle, 2005) but is also a key concept in understanding the rupture between value creation and places of production (Ting, 2014: 71). Separate entities are fictional in a world where enterprises plan their operations as a single economical unit (Biondi, 2013; Biondi, Canziani, & Kirat, 2007; Graham, 2003). This facilitates artificial wealth creation in locations that attract multinational enterprises with tax incentives (Palan, 2002).

This multidisciplinary paper also answers to a call by O'Dwyer and Unerman (2014: 1227) for greater integration 'of theoretical framings drawn from multiple disciplines'. The remainder of this article progresses as follows. In the next section, we will review the key literature on tax avoidance and global wealth chains. In Section 3, we introduce principles of mining taxation and the characteristics of the Finnish metal ore mining industry and its regulation. Section 4 describes our research materials and methodology, and Section 5 is devoted to the case studies. The penultimate section discusses the case studies in light of the questions posed in this introduction. We conclude by discussing the implications of this study in the context of wider developments in corporate taxation.

## 2. Review of earlier research

### 2.1. Quantitative and qualitative research on tax avoidance

The impact of tax avoidance has been mostly studied quantitatively with econometric methods.<sup>2</sup> The branch of quantitative studies began with a study by Hines and Rice (1994), who disentangled profit shifting from real economic profits and analyzed the 'semi-elasticity of reported income with respect to the tax rate differential across countries' (Dharmapala, 2014: 2; for other recent summaries of these studies, see Heckemeyer & Overesch, 2013; OECD, 2015a).<sup>3</sup> These studies have focused on tax planning at an aggregate level, and the lack of publicly available data impacts the use of the methods (Lisowsky, 2010; OECD, 2015a). The vast majority of the European and global studies is based on the financial data of the Orbis database<sup>4</sup> (OECD, 2015a: 94–95). In the United States, researchers have also used confidential data collected by the United States Bureau of Economic Analysis (BEA) from U.S. based multinational enterprises (OECD, 2015a: 33). Both databases have severe deficiencies that we discuss later in this section. The poor quality of aggregate source data has meant that while most of these studies document the existence of tax avoidance, they do not reliably address the magnitude of its effects for economies or the types of arrangements used (Dharmapala, 2014). The OECD (2015a: 17) has also criticized econometric studies on tax avoidance for failures 'to disentangle real economic effects from the effects of BEPS-related behaviours' (see also Killian, 2006).

The most severe deficiency on the Orbis database is that it includes information from only a very few countries that are used in corporate tax avoidance. The database is not exhaustive, because it is based on public financial statements (Weyzig, 2014: 151). These are generally available only in Europe and a few other countries. Even in Europe, the database lacks crucial information from corporate tax havens such as Luxembourg and Switzerland (Huizinga & Laeven, 2008: 1170; Lohse & Riedel, 2013: 19). Therefore, the database fails to include a vast part of corporate tax avoidance, since it utilizes non-transparent tax havens (Dharmapala, 2014: 441). The absence of data from tax havens heightens the risk that these studies fail to illustrate the true magnitude and impact of tax avoidance. We tackle this obstacle by complementing our research material with original financial statements and consolidated annual returns that include information on cash flows to tax shelters (see Section 4).

The U.S. BEA database does not have a similar shortage of information from non-transparent hubs of tax avoidance, but it is limited because it only includes information on MNEs headquartered in the United States. This leaves out most of the global MNEs. Additionally, the generalizability of research based on the BEA database is limited, since the U.S. worldwide corporate tax system is exceptional (Kleinbard, 2011). Practically all other developed countries have a territorial tax system; i.e., they only tax the profits generated within their jurisdiction. Together with the fact that the 35% statutory corporate tax rate in the United States is by far highest in the OECD countries, this means that tax avoidance techniques of U.S. based multinationals as well as their effects are unique and differ from those employed by Canadian or European MNEs. The tax avoidance techniques of Canadian MNEs highlighted in our case studies could however be employed within most territorial tax regimes.

Another shortcoming of previous quantitative research is its focus on statutory corporate tax rates. Due to the lack of information from corporate tax havens and countrywide effective tax rates, many studies compare pre-tax profits with statutory tax rates (OECD, 2015a: 94–95). Controlled foreign company (CFC) rules and other anti-tax avoidance measures restrain the use of tax havens with low or no corporate taxation (see Section 3.2). Because of this, tax avoidance especially in the EU relies usually on specific tax incentives and tax rulings granted by jurisdictions that often have above average

<sup>2</sup> E.g., Bartelsman and Beetsma, 2003; Becker et al., 2012; Buettner and Wamser, 2007; Clausing, 2003; Clausing, 2016; Desai et al., 2005; Dischinger and Riedel, 2011; Grubert and Mutti, 1991; Hines and Rice, 1994; Huizinga and Laeven, 2008; Kosi and Valentincic, 2013; Markle and Shackelford, 2009.

<sup>3</sup> According to Dharmapala (2014), "A representative consensus estimate from the literature, based on a metaregression study by Heckemeyer and Overesch (2013), is a semi-elasticity of reported income with respect to the tax rate differential across countries of 0.8. This entails that a 10 percentage point increase in the tax rate difference between an affiliate and its parent (e.g., because the tax rate in the affiliate's country falls from 35% to 25%) would increase the pretax income reported by the affiliate by 8% (for example, from \$100,000 to \$108,000)."

<sup>4</sup> Bureau van Dijk's database contains financial information on over 170 million companies worldwide. Some studies are also based on Bureau van Dijk's Amadeus database that has similar information only on European companies.



statutory tax rates (Marian, 2016a; OECD, 2013). Our case studies are illustrative examples of this, since the tax avoidance arrangements we analyze rely on specific tax incentives granted for example by Luxembourg.

Moreover, publicly available raw data in financial statements included in the Orbis database often fails to give unequivocal information on tax costs and thus requires further interpretation (Hanlon, 2003: 850–852). Due to the fact that Orbis does not include explicit information on tax residence, statistical studies generally presume that the formal registration jurisdiction is also the residence jurisdiction for tax purposes. However, relying on this presumption could significantly warp the data as tax jurisdiction differs from registration jurisdiction specifically in tax avoidance cases. First, the permanent establishments that are taxable parts of entities are often employed in tax avoidance (OECD, 2015c). However, they are not included in databases, since they do not file their separate financial statements to public registries. Second, some countries do not necessarily tax all entities registered in there, which is a feature that is a common tool for tax avoidance. As for example, Ireland has not taxed the Irish subsidiaries of Apple and many other American MNEs in cases where their business has been effectively managed outside Ireland (Ting, 2014). These MNEs have been able to avoid billions of euros of taxes by shifting a large share of their profits to the Irish subsidiaries that are not tax resident in Ireland, but in a tax haven such as Bermuda. Another disturbing factor in the previous statistical studies is the rough classification of financial data in Orbis. The taxable income often differs from the pre-tax profits presented in Orbis for other reasons than tax avoidance. As for example, the intra-group dividends accounted in profits are usually wholly or partially tax exempt.<sup>5</sup> We are able to take into account these deficiencies of raw data or at least analyze their possible impact when we discuss the limitations of our research (see Section 6.5).

The few earlier tax avoidance case studies have used material from public hearings (Otusanya, 2011; Ting, 2014), court decisions (Bal, 2016; Otusanya, 2011; Sikka & Willmot, 2010; Waris, 2016), research reports from non-governmental organizations (Wu, 2015), public financial account data (Ylönen & Laine, 2015) and information acquired directly from enterprises (Ali-Yrkkö & Rouvinen, 2015). These studies suggest that a qualitative approach can help to understand tax avoidance structures, their underlying reasons (Ting, 2014; Ylönen & Laine, 2015) and the global division of value added between MNE functions as they show tax planning is decisive in determining where profits are accounted (Ali-Yrkkö & Rouvinen, 2015). The case studies also highlight the deficiencies of a quantitative approach using aggregate data from financial account databases as it fails to include information on the discovered high-profile tax avoidance affairs (OECD, 2015a: 19).

While the case studies provide 'a rich and emerging source of evidence' on BEPS arrangements (OECDa, 2015: 17), their small number and incidental nature limits their usability for broader analysis. Our systematic industry-wide multiple case study approach described in Section 4 improves the generalizability of the findings significantly.

## 2.2. From value chains to wealth chains

The dominant quantitative research on corporate tax avoidance has demonstrated the blatant gap between the places where MNEs book their profits and where the actual value is created. However, other tools are needed to assess the impact that this discrepancy has on the balance of power between MNEs and states. The global wealth chain approach that draws from the studies on global value chains can be useful in conceptualizing how MNEs exert power over states with their tax planning capabilities.

The global value chain research agenda emerged from the economic dependency research within the studies of international development, and its main focus was on the relationship between *the core* and *the periphery* of the world-economy. Known especially from the works of Immanuel Wallerstein and his colleagues (Hopkins & Wallerstein, 1977), these ideas were later turned into a new research agenda under the title global commodity chains (Gereffi & Korzeniewicz, 1994). Consequently, this resulted in a large body of empirical research on intra-firm and inter-firm value chains (e.g., Daviron & Ponte, 2005; Ponte & Gibbon, 2005; Sturgeon, Van Biesebeek, & Gereffi 2008). The value chains research agenda gained popularity as it was realized that the core-periphery approach was not sufficient to describe the globalized economy where MNEs are able to outsource much of the activities that were conducted before within the MNEs themselves to almost any place in the world. Wallerstein's framework was based on the capitalist world-economy as it had existed for some 500 years before the economic globalization that has dramatically changed the economy in the past few decades (Patomäki, 2003). The revolution of the global economy was also noted in international business research, where the work of Michael Porter (1985) played a key role in steering the research agenda of corporate value chains. Consequently, many researchers began to study the commodity and value chains involving several enterprises, and the increased understanding of the role of the service economy shifted the focus from commodities to more general value chains.

More recently, research on financialization and the offshore economy (Palan, 2002) has underlined that the value chain framework alone cannot explain where the profits of international business are booked and for what reasons. A number of scholars have pointed out how 'decentered corporations' (Desai, 2008) utilize power over states that attempt to design and impose effective tax laws on corporations (Genschel and Rixen, 2014). There is a need for more research into how enterprises are able to design fictional wealth chains that 'hide, obscure and relocate wealth to the extent that they break loose from the

<sup>5</sup> This is meant to relieve economic double taxation within MNEs, since usually the entity paying out the dividend has already paid income tax for its profits. The dividends are paid out of accumulated after-tax profits.

location of value creation' (Seabrooke & Wigan, 2014a: 7; see also Seabrooke & Wigan, forthcoming). The wealth chains within MNEs are in many ways fictional as the *arm's length* transfer prices are determined by methods not used in the business-to-business markets where the prices are generally based on supply, demand and negotiations.

Statistical studies on corporate tax avoidance (see Section 2.1) have highlighted the fact that much wealth is being relocated within large corporations in ways that break from the location of actual value creation. However, global wealth chains thrive in secrecy and complex financial arrangements that undermine some of the key assumptions in quantitative strain of tax research. As for an example, our case studies show that the statutory corporate income tax levels – a common variable in the quantitative studies – played a relatively minor role in the tax arrangements we analyzed. Moreover, much of the econometric research on corporate tax avoidance departs from the notion of the arm's length principle. However, the concept is only *a theoretical principle*, i.e., the in-practice price setting of intra-group transactions is part of a tax planning policy rather than *actual* arm's length pricing (Ylönen & Teivainen, 2015). The scarce critical literature on the arm's length principle usually discusses its abuse in the context of the mispriced trade of services and goods within enterprises (Ylönen & Teivainen, 2015). However, the same principle also applies to intra-group interests (Heckemeyer & Overesch, 2013). These deficiencies of the international tax system give multinational enterprises an increasing 'autonomy with the absence of constrained choice or limits to choice or behavior' (Samuels, 1972: 277).

Global wealth chains cannot be fully analyzed and understood without in-depth firm-level research. The case study approach, we utilize in this article, not only allows a detailed analysis on the nuances of the tax planning arrangements commonly employed by the MNEs (i.e., how wealth chains are structured), but is also helpful in understanding how MNEs and their front groups are able to lobby and maintain legislation that facilitates tax avoidance even in highly developed countries such as Finland.

### 3. Mining taxation and the metal ore mining industry in Finland

#### 3.1. Taxing the mining industry: concepts, developments, and challenges

Mining is a peculiar industry. Some of the central characteristics highlighted in mining studies are the finite and immobile nature of ores, and the major environmental and social effects and risks created by their extraction (Otto et al., 2006: 19). Mineral resources are typically considered to be a part of national wealth, and the resource rights are owned by the state (Guj, 2012: 3; Ministry of Employment and the Economy, 2010: 2). These factors give weight to demands for charging 'rent' from mining enterprises (Baunsgaard, 2001: 5). The rent is a compensation for the mine's location jurisdiction and is usually charged in the form of a tax. Mining policies typically aim to manage the exploitation of extractives for the benefit of the communities involved, maximizing the revenues in the long term (Guj, 2012: 5–7). Other objectives should also be taken into account, such as revenue stability, equity between taxpayers, transparency, and administrative efficiency (Guj, 2012).

Corporate income tax (CIT) is only paid from taxable profits; therefore, it is not an adequate tool for charging rents from mining enterprises (Boadway & Keen, 2010: 32–44). Consequently, there is a myriad of mining-specific taxes (Guj, 2012: 4–5). Exploration and mining are risky but can also result in high rewards. In order to be effective, mineral taxes should be sufficiently low to enable the initial high capital investment and exploration costs. However, the rents should be sufficiently high to compensate for the right to exploit national resources and for the potential damages. As a result, most countries have resorted to a regular CIT supplemented with a royalty system. Governments often mix instruments in order to achieve a balance between economic efficiency and effectiveness in raising revenues (Barma, Kaiser, & Le, 2012: 123; see also Otto et al., 2006: 278).

Early mining royalty systems were typically based on the amount of production. However, since the 1950s, value-based royalty systems (*ad valorem*) have gained popularity as production-based royalties can tilt the production path by reducing initial output (Baunsgaard, 2001). Mining royalties are usually project-based, and a few countries aim to secure CIT revenues from the natural resources industry with a 'ring fencing' system that prohibits offsetting profits from one mine with losses to another mine belonging to the same enterprise (Guj, 2012: 4; Barma et al., 2012: 125).<sup>6</sup> In addition to the CIT and *ad valorem* royalty systems, presumptive income taxes, resource rent taxes, and property taxes are also common as well as other taxes such as value-added tax and import and export duties (Barma et al., 2012: 125).

#### 3.2. The Finnish mining industry and its regulation

Finland has a notably long mining industry history, as the first mines were established in the sixteenth century (Puustinen, 2003). Since then, minerals have been extracted from over 1000 mine sites. After a surge in new mines in the post-war decades, the significance of the mining industry declined in the 1980s. In the following decade, the training of mining professionals was downsized (Lindborg, 1996: 180). Technical development and the commodity price boom of the early 2000s led to the revival of mine exploration and the opening of 10 new metallic ore mines in this millennium (Kaldany, 2006: xi). There were 12 operational metallic ore mines at the end of 2013 (Finnish Safety and Chemicals Agency, 2013). In addition, there was extraction of other minerals at 34 mines. The industry's total turnover was around €1.5 billion in 2013,

<sup>6</sup> Finland does not have a ring fencing system.

out of which metal ore mines accounted for €1.1 billion, and the mines employed approximately 3000 people directly, with some 27,000 indirectly employed (Kokko, 2014; Ministry of Employment and the Economy, 2014). Notwithstanding, the GDP share of the mining industry in Finland was estimated at only 0.3% in 2014 (Official Statistics of Finland, 2016). With falling market prices, six mines were closed in 2014. In the beginning of 2016, there were no pending mine projects. Investments in mine exploration slumped to €40 million in 2014 from nearly €90 million in the peak year of 2012, and the downward trend is expected to continue (Finnish Safety and Chemicals Agency, 2015).

Finland began revising its mining legislation in 2009. The government proposal briefly discussed different mining royalty systems (Government of Finland, 2009). However, the idea of introducing specific mining taxes was abandoned.<sup>7</sup> The new Mining Act (621/2011) came into effect in 2011. It allowed exploration without a permit in most cases and granted the explorer an exclusive right to exploit deposits. The required exploration permits are relatively cheap and are denoted to cover only the immediate costs of the authorities (Government of Finland, 2009). Moreover, whereas in the past compensation was negotiable, the mining company must now compensate the landowner 0.15% of the value of the extracted minerals annually. The National Geological Survey of Finland (GTK) has also been involved in exploration. The Finnish government sells the rights to mine sites discovered by the GTK. In at least one case, the sale has resulted in a royalty agreement (see Section 5.3). These royalties are not taxes since they are contract-based. According to the Finland State Budget, the total amount of royalties is expected to be €3 million in the year 2015, which accounts for less than half percent of the value of all ores mined in Finland.

In general, the structure of the Finnish corporate tax regime is similar to most developed countries and Finland is not involved in harmful tax competition that would attract profit shifting from abroad (European Commission, 2015b).<sup>8</sup> Mining companies pay the statutory CIT for their taxable profits.<sup>9</sup> In 2014, the tax rate was reduced from 24.5 to 20%, which is relatively low,<sup>10</sup> but still considerably higher than effective tax rates in the countries engaged in harmful tax competition (Marian, 2016a). Tax competition in developed countries is usually in form of specific tax incentives or rulings that provide a low effective tax rate for profits generated for example by intra-group interests or intellectual property (Zammit, 2015).<sup>11</sup> Our cases demonstrate that even with the relatively competitive statutory CIT rate profits are shifted away from Finland due to the special tax treatment in Barbados and Luxembourg.

As in other OECD countries, all intra-group transactions in Finland should be at arm's length and the OECD (2010) Transfer Pricing Guidelines are used to interpret the arm's length principle (Finnish Tax Administration, 2009, Act on Assessment Procedure, 1558/1995, §31). However, there are a few exceptions to the general principle that facilitate tax avoidance. According to case law (KHO:2014:119), the general anti-avoidance rule (Act on Assessment Procedure, §28) provides the only legal basis for the authorities to re-classify interest-carrying loans as equity, which significantly reduces the possibilities for re-characterizing tax-deductible interests as non-deductible dividends. Due to this, it is unlikely that the Finnish tax authorities would challenge the thin capitalization arrangements described in this article. The Finnish group relief system also allows intra-border group contributions that enable local subsidiaries and permanent establishments to offset profits and losses (Contributions between Affiliated Companies Act, 21.11.1986/825). We show how this enables restructurings that create huge tax-deductible interests not related to any real investments (see Sections 5.2 and 5.3). Mining companies are also able to offset their mining profits with losses from other activities (see Sections 5.2–5.4). Losses can be carried forward for ten years (The Income Tax Act, 30.12.1992/1535, Section V), which allows deferred tax savings from excess interest costs in the starting phase of a mine, when the business is generally loss-making and there is no tax on profits to be paid (see Section 5.2). With certain limitations, companies can exploit previous losses after mergers and acquisitions (see Section 5.4). There is no withholding tax for interest paid abroad, and generally, all intra-group payments to other EU countries are exempt from withholding tax (see directives 2011/96/EU and 2003/49/EC).

The lack of withholding tax on interest allows the full benefit of interest tax deductions in thin capitalization structures. The tax exemption of intra group dividends in the EU enables using holding companies registered in the EU for avoiding the Finnish withholding tax on payments to third countries. All three case enterprises used Swedish holding companies to avoid the Finnish withholding tax (Sections 5.2–5.4). The tax treaties Finland has with most developed third countries dictate that withholding tax on dividends paid directly outside the EU is usually five percent (Finnish Tax Administration, 2014b).<sup>12</sup>

Most countries limit cross-border tax avoidance with specific regulations such as CFC rules, thin capitalization rules and the general anti-avoidance rule (GAAR). Finland has GAAR and CFC legislation in place, but the EU case law limits their application on low-tax subsidiaries registered in the EU area (Finnish Tax Administration, 2014a; C-196/04 – Cadbury

<sup>7</sup> In 2012, the Ministry of Employment and the Economy commissioned a consultancy study from a Swedish private consulting firm to review a large number of tax regimes. This study concluded that regions with a large market share and other stable regions (e.g., South Africa) were increasing their resource taxes while mainly developing countries with unstable regimes were looking to expand their market share with lower tax rates (Ericsson & Farooki, 2012). Curiously, the study was never published. We were only able to obtain the study after submitting an official information request.

<sup>8</sup> For an in-depth study on international corporate taxation in Finland, see Helminen (2015).

<sup>9</sup> Taxable income is calculated according to the Business Tax Act (360/1968). Calculations are based on financial statements prepared according to the Finnish Accounting Act (1336/1997).

<sup>10</sup> The sixth lowest among OECD countries (OECD, 2016).

<sup>11</sup> The LuxLeaks documents showed that Luxembourg has given advance tax rulings to MNEs that often provided effective tax rate below one percent in a country where the statutory corporate income tax rate has remained relatively high at 29%. The intellectual property tax incentives usually offer a tax rate between 5 and 10% (European Commission, 2014).

<sup>12</sup> If there was no tax treaty between Finland and the resident country of the dividend recipient, the withholding tax rate would be 30%.

**Table 1**

Collected figures from all Finnish mines 2011–2014 (€ million).

Mine/Parent company (country)	Mining company and other Finnish subsidiaries <sup>a</sup>	First year of production	Total ore revenue	Aggregate operating result	Total CIT costs Finland <sup>b</sup>	Equity (2014) <sup>c</sup>	Liabilities (2014) <sup>d</sup>	Equity ratio <sup>e</sup>	Thin capitalized (yes/no) <sup>f</sup>	Main ore	Additional information
Hitura/ Belvedere Resources Ltd (Canada)	Belvedere Mining Oy	1970	54.3	–1.6	0.0	–0.8	3.9	negative	no	nickel	Production shutdown since 2013 due to low nickel price. Two other subsidiaries in Finland. Negative equity due to losses.
Jokisivu and Orivesi/ Dragon Mining Ltd (Australia)	Dragon Mining Oy	2009/2007	103.7	–27.6	0.0	–17.6	32.5	negative	no	gold	Same company operates two mines and also a processing plant in Sastamala. Negative equity due to losses.
Kemi/ Outokumpu Plc (Finland)	Outokumpu Chrome Oy	1966	1213.7	195.0	0.0	120.7	534.3	18%	no	chrome	Has offset profits with loss-making group companies in Finland. Stainless steel production is Outokumpu Plc's main business.
Kevitsa/First Quantum Minerals Ltd (Canada)	FQM KH No. 1 Oy Kevitsa Mining Oy	2012	379.3	7.5	2.6	–133.9	954.3	negative	yes	copper	See Section 5.2 and Table 2.
Kylylahti/ Altona Mining Ltd (Australia)	Kylylahti Copper Oy <sup>g</sup>	2010	115.8	22.2	0.0	–27.4	95.7	negative	yes	copper	Swedish Boliden AB acquired the mine in 2014. Four other subsidiaries in Finland. Former Boliden subsidiaries not accounted.
Laiva/Nordic Mines AB (Sweden)	Nordic Mines Oy	2011	81.4	–111.4	0.0	12.7	30.7	29%	no	gold	Production shutdown since 2014 due to low profitability. Negative equity due to losses.
Pahtavaara/ Lapland Goldminers AB (Sweden)	Lapland Goldminers Oy	2008	61.1	n/a	0.0	n/a	n/a	n/a	no	gold	Figures from the Finnish subsidiary missing, because of bankruptcy early in 2014. Sales based on parent company annual reports 2011–2013.
Pampalo/ Endomines AB (Sweden)	Endomines Oy	2011	82.0	–3.5	0.0	17.4	14.5	55%	no	gold	One other subsidiary in Finland.
Pyhäsalmi (First Quantum Minerals Ltd (Canada)	Pyhäsalmi Mine Oy Inmet Finland Oy	2001	629.7	303.7	71.5	118.5	49.8	70%	yes	copper	See Section 5.3 and Table 3.
SuuriKuusikko/ Agnico-Eagle Mines Ltd (Canada)	Agnico-Eagle Finland Oy	2009	676.2	244.9	18.1	181.8	365.8	33%	yes	gold	See Section 5.4 and Table 4.
Talvivaara/ Talvivaaran Kaivosos. Plc (Finland)	Talvivaaran Kaivososakeyhtiö Plc	2008	464.1	–895.4	0.0	–729.9	741.2	negative	no	nickel	Figures are based on consolidated IFRS accounts. The group has one additional company in Finland. Bankrupt in 2014.
Total sales	3861.4	Total CIT		92.2		Total CIT/ Sales				2.4	%

The figures are based on financial accounts according to the Finnish GAAP with an exception of Talvivaara. The data is sourced from Orbis, financial statements and the Finnish Tax Administration.

<sup>a</sup> Only significant subsidiaries listed.

<sup>b</sup> Includes all Finnish subsidiaries. Figures based on the Finnish tax administration figures. Kevitsa has paid no tax according to its financial statements.

<sup>c</sup> Total additional depreciations are included in equity.

<sup>d</sup> Provisions are included in liabilities.

<sup>e</sup> The ratio was calculated by dividing the equity with the total liabilities and equity.

<sup>f</sup> Thin capitalized due to tax planning. Some companies were thin capitalized at least partially due to losses. See Section 5.4.

<sup>g</sup> Kylylahti Copper Oy's accounting period ends in June. Its name was changed to Boliden Kylylahti Oy in 2014.

Schweppes and Cadbury Schweppes Overseas). In 2014, the government also introduced a new rule limiting the intra-group interest deductions (Business Tax Act §18a). Despite its proportional coverage, a study commissioned by the EU Commission pointed out 12 loopholes in the Finnish tax legislation that facilitate tax avoidance (European Commission, 2016b). Our case studies in Section 5 demonstrate how these loopholes are exploited in an interplay with the tax regimes of other countries (see also e.g. Altshuler and Grubert, 2005; Killian, 2006).<sup>13</sup>

#### 4. Research methodology and the selection of the case enterprises

In contrast to the mainstream quantitative approach described in Section 2.1, we combined an industry-wide analysis of financial accounts accompanied with a multiple case study of MNEs that were particularly interesting in the light of our research questions. The qualitative approach is useful in increasing understanding of complex social phenomena such as tax planning and in allowing access to previously unknown observations (Yin, 2003). Moreover, the multiple case study approach allows for highlighting the societal and legal factors behind tax-driven wealth chains in ways that quantitative methods would not. The central idea of the multiple case study method is to constantly compare theory to the research findings arising from the cases (Eisenhardt, 1989: 541).

Our approach differs from previous case studies (see Section 2.1) as we chose multiple enterprises based on a systematic industry-wide screening instead of analyzing just a single case enterprise based on earlier media coverage or public inquiries that have revealed the tax avoidance structures (Ting, 2014; Ylönen & Laine, 2015). The material consisted of both consolidated and subsidiary level numeric financial accounts and we complemented this with information from annual reports. Our industry-wide approach accompanied with the three critical and revelatory cases (Yin, 2003: 42) provide generalizable information (Yin, 2003: 53–54) on the difficulties that Finland faces in taxing its mining sector enterprises in the sense that ‘if it happens there, it will happen everywhere’ (Patton, 1990: 174). By doing this, we open up new avenues for qualitative generalization, which has received too little attention in the accounting research (Parker & Northcott, 2014).

The availability of the financial statements of local subsidiaries in most European countries as well as that on taxable income and taxes paid in Finland provided the starting point for the systematic selection of case studies. First, we acquired publicly available financial data of 2011–2013 from all enterprises mining metallic ores at the 12 mines operating in Finland in 2013 (see Table 1). This data included not only the financial statements of local subsidiaries but also stock exchange data, such as the consolidated annual reports and a number of financial statements of non-Finnish subsidiaries that were relevant for the operations in Finland. We also utilized data from corporate websites and the Orbis database. To improve the validity of our findings, we consequently also included financial data from 2014 as it became available during the research process.

A preliminary screening of this data enabled us to obtain a reliable overall picture of the business models, corporate structures, and the profitability of the 12 mines. We chose the mines for case studies specifically based on two criteria. First, we looked for companies whose actual business operations had been highly profitable in Finland and therefore the enterprise had an incentive to shift taxable profits abroad.<sup>14</sup> Second, we were interested in companies that appeared to have thin capitalization arrangements based on the initial screening.<sup>15</sup> This criteria allowed us to assess the external and internal validity of the case studies so that they would provide relevant information on tax avoidance and its impact on wealth chains (Yin, 2003: 34–35).

The screening revealed that six out of the eleven companies operating the mines failed to generate tax revenues because they were unprofitable during the period and were therefore not interesting cases for in-depth studies<sup>16</sup> (see Table 1). Two have filed for bankruptcy since then. Three out of the five profitable mines (Kevitsa, Pyhäsalmi and Suurikuusikko, discussed in Section 5) have generated corporate income tax (CIT) with Kevitsa doing so for the first time in 2014. The Kylylahti mine has been profitable but generated no income tax due to high interest costs and being in the start-up phase. Based on this and the fact that the mine was significantly smaller compared to the other four profitable mines we left it out of the final sample. We assume that the Kylylahti mine will pay income tax in the future. The fifth profitable mine (Kemi) was operated by the loss-making Outokumpu Plc that was able to consolidate its mining profits with the losses of other Finnish group companies. As a result, Outokumpu lacked the motivation for cross-border profit shifting and we excluded the mine from the case studies.

Based on the screening of the financial statements, we could preliminarily identify that the three remaining companies were thinly capitalized due to tax planning (see Table 1) and therefore suitable for closer scrutiny.<sup>17</sup> The three mines were

<sup>13</sup> In June 2016, the Council of the EU adopted an anti-avoidance directive (EU/2016/1164) that incorporates rules proposed in the OECD BEPS action plan for the legislation of the EU member states. In addition to the rules discussed above, the directive includes a switch-over clause to prevent double non-taxation of certain income, an exit taxation rule to prevent companies from avoiding taxation when re-locating assets and a hybrid rule to prevent companies from exploiting national mismatches to avoid taxation. These rules were not previously incorporated in the Finnish legislation, but other rules such as the GAAR might have limited the use of such arrangements in some cases. Adoption of the directive would set a minimum legislation standard that would close a few of the loopholes deliberately offered by some member states.

<sup>14</sup> Operating margin positive.

<sup>15</sup> High intra-group loans and/or interest costs.

<sup>16</sup> The Orivesi and Jokisivu mines were both operated by a single company.

<sup>17</sup> In addition to these three, we considered the Kylylahti mine to be thin capitalized due to tax planning reasons. These four thinly capitalized companies belonged to either a Canadian or Australian MNE. Of the seven other mining companies, five had lost their equity at least partially due to losses and not only because of tax planning. The last two companies that did not appear to be thinly capitalized belonged to a Finnish and Swedish mining enterprise.



operated by two enterprises, Agnico Eagle Mines Ltd (AE) and First Quantum Minerals Ltd (FQM). A further justification for the case study selection was that the mines operated by AE and FQM had been operational for several years before 2014, which enabled the assessment of tax implications over the lifetime of the mines with sufficient data for the research. The mines are the three largest metallic ore mines operated by foreign-based MNEs in Finland in terms of production as well as profits.

In undertaking the case studies, we analyzed the business activities at the three mines and the associated corporate structures from the exploration phases until the end of 2014. We acquired the relevant financial statements and annual reports from 2001 when mining began at the first of the three mines, the Pyhäsalmi mine. Based on this information, we analyzed all acquisitions and restructurings related to the mines from a tax avoidance perspective. Therefore, the case studies also involve enterprises that owned the mining rights earlier. The material revealed a number of foreign holding companies and other subsidiaries related to the structures. We acquired the financial statements of these subsidiaries as well, when they were available. After completing the draft versions of the case studies, we strengthened their reliability by sending the key findings to AE and FQM, which both verified the findings described in the next section.<sup>18</sup>

We discovered that the case enterprises thrived on tax savings using seven different types of arrangements that erode the Finnish tax base. They were:

1. Using thin capitalization and intra-group loans to finance the local mining business (Sections 5.2–5.4)
2. Setting up a holding company that uses intra-group loans to purchase shares in the mining business in an intra-group restructuring (Sections 5.2 and 5.3)
3. Using intra-group loans to finance separate investments abroad (Section 5.3)
4. Acquiring mining rights in an intra-group arrangement to gain tax-deductible depreciations and amortizations<sup>19</sup> (Section 5.2)
5. Using a Swedish holding company to avoid the Finnish dividend tax at source and the transfer tax (Sections 5.2–5.4)
6. Offsetting profits from one mine with losses from another mine or business using the Finnish group contribution system (Sections 5.2–5.4)
7. Avoiding Finnish capital gains tax by entitling Finnish mining concessions to a foreign subsidiary (Section 5.2)

In the next section, we will discuss the case studies and tax avoidance arrangements in detail.

## 5. The case studies

### 5.1. How to read the case studies

The following sections discuss each of the case studies in three parts. We begin discussing each case by describing the history of the operations at the mines, treating the MNE as a single unit (Biondi et al., 2007; Biondi, 2013). After this, we discuss those arrangements that had tax effects. Finally, we proceed to analyze how these arrangements impacted tax liabilities. Our main focus is on the CIT losses of the Finnish government as these ores are sourced from Finland. However, we also briefly discuss how the tax arrangements affect subsidiaries in countries where profits are shifted, namely Barbados, Luxembourg, the Netherlands, and Sweden. Unless otherwise stated, all financial information and information on activities are from consolidated annual reports (AR), annual information forms (AIF),<sup>20</sup> and public financial statements (FS) of the local subsidiaries at issue. The complete list of the research material and other data used in the screening and research is in Appendix A. Depending on the currency in the original source, the financial figures are presented in either euros (€) or United States dollars (\$). The local financial statements including those from Finland have been prepared according to local accounting laws and the consolidated accounts according to the IFRS standard.

### 5.2. The FQM Kevitsa mine: tax planning by intra-group loans and holdings companies

#### 5.2.1. Description of FQM and the Kevitsa mine

FQM is a Canadian mining and metals enterprise producing copper, nickel, gold, zinc, and platinum group elements. Incorporated in 1983, the enterprise is publicly listed on the Toronto, London, and Lusaka stock exchanges. The parent company, First Quantum Minerals Ltd, is incorporated in the Canadian province of British Columbia and has headquarters in

<sup>18</sup> This was done while preparing a separate report published by a Finnish corporate responsibility research NGO Finnwatch. In the report, we presented some of our factual findings on the tax arrangements. The original responses are available in full as annexes of the report (Finnwatch, 2016: 36–40).

<sup>19</sup> Depreciations are regular decreases in tangible asset value, in contrast to amortizations that result in the decrease in value of intangibles. Both are costs that decrease profits and are usually deductible from taxable income. They are usually made schematically in relation to elapsed time in contrast to value adjustments based on the observed value difference between the balance sheet and real asset value. The posterior write downs are also often tax-deductible, but deferred compared to accounting.

<sup>20</sup> Canadian publicly listed enterprises are required to submit specific annual information forms in addition to their annual reports.

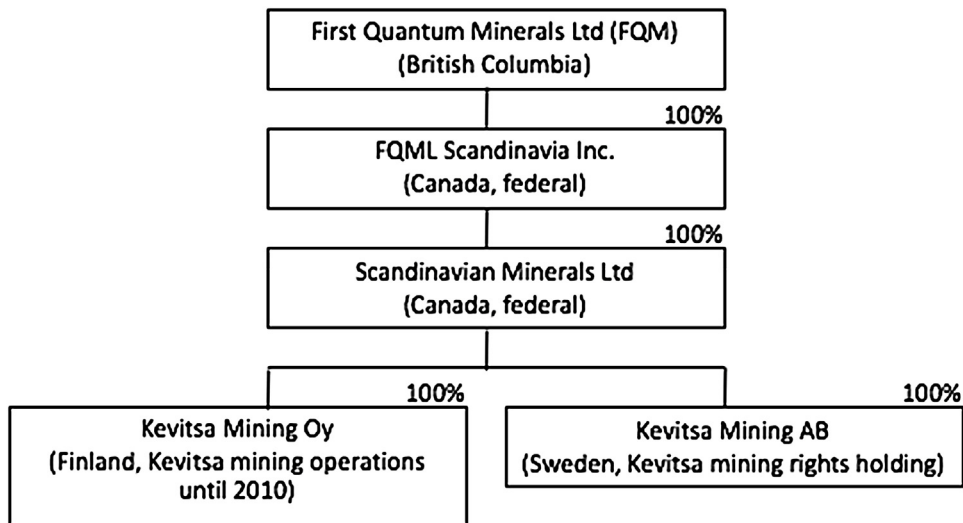


Fig. 1. The corporate structure of FQM Kevitsa mine before the restructurings as of December 31, 2008 (FQM, AIF 2008).

Vancouver. At the end of 2013, it directly or indirectly owned around 100 subsidiaries (FQM, AIF 2013).<sup>21</sup> FQM operates the Pyhäsalmi and Kevitsa mines in Finland. Its five other mines are located in Zambia, Mauritania, Spain, Australia, and Turkey. In addition, FQM has four mine development projects in South America and Africa (FQM, AR 2015).

Kevitsa is an open-pit mine in northern Finland with large deposits of nickel, copper, cobalt, and platinum group elements. The National Geological Survey of Finland first discovered the deposits in 1987. After a short-lived development attempt by the Finnish-based Outokumpu Plc., the Canadian-based Scandinavian Minerals Ltd.<sup>22</sup> claimed the deposit in July 2000. In June 2008, FQM bought the mine development project by acquiring Scandinavian Minerals for a total purchase price of \$278 million (FQM AR, 2008). FQM then launched commercial ore production in August 2012. The mine employed 345 people in December 2014, and the total sales revenue for 2014 was €164 million. The mine is expected to deplete by 2042 (FQM, AR 2014).

### 5.2.2. Tax planning arrangements

When FQM acquired the mining concessions in 2008, they were held by Kevitsa Mining AB,<sup>23</sup> a Swedish holding company with no employees, directly owned by Scandinavian Minerals Ltd (see Fig. 1). In 2010, FQM transferred the concessions, assets, and loans related to the mining business to a newfound Finnish subsidiary, FQM Kevitsa Mining Oy. Kevitsa Mining AB received shares from FQM Kevitsa Mining Oy in return but paid no income tax in Sweden for the capital gains of €285 million (Kevitsa Mining AB, FS 2010).<sup>24</sup> Around the same time, FQM rearranged the corporate structure of Kevitsa business by adding three holding companies to the group structure. Under the new structure, the Swedish-based FQM Kevitsa Sweden Holdings AB was made the owner of the Finnish-based FQM Kevitsa Holding No. 1 Oy, which owned the shares of FQM Kevitsa Holding No. 2 Oy, which subsequently owned Kevitsa Mining AB. The Finnish exploration company, FQM FinnEx Oy, was also set up (see Fig. 2).

### 5.2.3. The impact of the arrangements

The arrangement generated three types of future tax benefits in Finland. First, FQM Kevitsa Mining Oy was entitled to deduct the depreciations and amortizations of transferred assets from its taxable income. These assets amounted to a total of €379 million at the end of 2010, out of which €287 million came from mining concessions. However, it is impossible to estimate the total benefit deriving from the depreciation and amortization because the financial statements do not specify their tax-deductible proportion.<sup>25</sup> Second, FQM inserted a Swedish holding company, FQM Kevitsa Sweden Holdings AB, between its Finnish subsidiaries and the Canadian parent. This created tax consequences as well, demonstrating the ability of

<sup>21</sup> Of these, 20 were fully owned subsidiaries incorporated in traditional tax havens (IMF, 2000), such as the British Virgin Islands, where FQM has no significant business activity.

<sup>22</sup> Then named Scandinavian Gold Ltd.

<sup>23</sup> Named Scandinavian Gold Prospecting AB before the acquisition.

<sup>24</sup> The EU Merger Directive (90/434/EEC) may provide a legal basis for this, as it exempts certain intra-group restructurings from tax. However, we were not able to confirm this from the public accounts.

<sup>25</sup> The mining concession depreciations may not be entirely tax-deductible if the transfer of assets to FQM Kevitsa Mining Oy was performed according to the EU Merger Directive (90/434/EEC). In that case, the appreciation of the assets' realized worth of approximately €287 would not be deductible as the principle of continuity would be applied on a tax-deductible depreciation basis (The Business Tax Act, §52d).

FQM to exploit the separate entity doctrine of corporate taxation (see Section 6). Had a Canadian company become the direct owner of the Finnish subsidiaries, Finland would have levied a five percent withholding tax on the dividends paid to the Canadian parent company (Finnish Tax Administration, 2014b). However, both Finland and Sweden are members of the EU, and intra-group dividends paid to other EU member states are tax-exempt. The dividends paid from Sweden to Canada could again be free from the Swedish withholding tax if they qualify for the Swedish participation exemption regime (Deloitte, 2014: 6).<sup>26</sup> The use of a Swedish holding company could mean an exemption from the Finnish transfer tax in the event the business is sold to a new owner (Finnish Tax Administration, 2015a).

Third, FQM was able to thin capitalize, or more precisely un-capitalize, the capital structure of its Finnish subsidiaries with intra-group loans. There were two reasons for this. First, FQM Kevitsa Mining Oy received not only assets but also debts in the rearrangement, most of them from intra-group companies. These were worth €87 million at the end of 2010. Since then, the company has financed its mining investments with similar loans, thus increasing the total amount of loans to €547 million in 2014. Second, FQM Kevitsa Holding No. 1 Oy used intra-group loans of €275 million to purchase shares in its subsidiary FQM Kevitsa Holding No. 2 Oy in the intra-group restructuring. The interest costs have increased these debts to €394 million by the end of 2014, with the company assuming a consolidated negative equity of €134 million with its Finnish subsidiaries (see next paragraph). These un-capitalization arrangements exemplify the separation of *fictional* intra-firm wealth chains from the *actual* value chains, as well as the ways MNEs can reorganize their property for withstanding demands from the governments of the countries where they operate (see Section 6.3).

FQM has had five subsidiaries in Finland, four of which are related to the Kevitsa mine, with the fifth engaged in unprofitable exploration activities. Considering that the Finnish group contribution system allows FQM to consolidate the taxable results of the subsidiaries, we considered them together as a sub-group when analyzing their capital structure and tax implications.<sup>27</sup> Moreover, FQM Kevitsa Holding No. 1 Oy consolidates its sub-group accounts in its financial statements. These consolidated accounts include all the other Finnish subsidiaries with the exception of Kevitsa Mining Oy (see Fig. 2). The consolidated accounts also include the Swedish-based Kevitsa Mining AB, but this has no significant impact on the consolidated figures as it is essentially a sub-group holding company with no significant transactions or assets outside the group. Both the FQM Kevitsa Holding No. 1 Oy sub-group and the Kevitsa Mining Oy have had negative equity in the period 2011–2014. Both of them are also financed entirely by intra-group loans. The loans of the FQM Kevitsa Holding No. 1 Oy sub-group totaled at €924 million at the end of 2014, and €36 million for Kevitsa Mining Oy. In comparison, the FQM group relied much less on debt financing, with a rather high equity ratio between 50 and 71% in the same period.<sup>28</sup>

While it seems evident that the Finnish subsidiaries were un-capitalized, the great annual variation in the intra-group financing costs of Kevitsa Holding No. 1 Oy complicates the assessment of the tax losses (see Table 2). Moreover, some subsidiaries have substantial intra-group financial income with no financial assets. We were unable to find an explanation for this from the financial statements, but the net effect of varying financial costs and income appears to stabilize over time. Acknowledging the limitations, we estimate that Kevitsa's thin capitalization arrangements has resulted in a CIT loss of €13 million for Finland by the end of 2014 (see Table 2 for calculations). We also maintain that the arrangements have significantly decreased the overall tax costs for FQM.<sup>29</sup> At the time of writing, Kevitsa had not generated any tax income for Finland even though the consolidated accounts show that the business has been profitable from the beginning of commercial production in 2012. In 2014, sales revenue from Kevitsa increased to \$271.4 million from \$197.6 the year before. Meanwhile, earnings before interests, taxes, depreciation, and amortization increased from \$56 million to \$93 million (FQM, AR 2013–2014). Should the Kevitsa operations remain profitable, the total net tax effects of the arrangement could mean dozens or even hundreds of millions of euros over the mine's lifetime. The future tax decrease is naturally subject to any major changes in the tax legislation.

The mining concessions were initially entitled to a Swedish subsidiary and were classified as intangible rights for tax purposes. Therefore, the Finnish Income Tax Act (§9 & §10) and the Nordic Tax Convention (Art. 6 & 13) would have most likely restrained Finland from taxing the capital gains of roughly €287 million from the immaterial rights even though the gains arose from the mine development in Finland.<sup>30</sup> The conclusion is subject to the condition that the rights did not belong to a permanent establishment in Finland, which seems unlikely in the given situation.

#### 5.2.4. Summary of tax avoidance arrangements

FQM employed four different tax planning techniques at the Kevitsa mine. First, it made two separate arrangements to un-capitalize the Finnish mining business. (1) It used intra-group loans to finance the mining investments; and (2) it set up a

<sup>26</sup> The participation exemption is generally meant to exempt intra-group payments from withholding tax to prevent the economic and judicial double taxation of corporate groups.

<sup>27</sup> Finland has limited the deductibility of certain intra-group interests from 2014 onwards (The Business Tax Act, §18a). This might have resulted in a corporate restructuring as four of FQM's subsidiaries in Finland merged into one at the end of 2014. The economic effects of the limitation are included in the 2014 figures.

<sup>28</sup> The ratio was calculated with balance sheet figures by dividing the total shareholder equity with the total liabilities and equity.

<sup>29</sup> Shifting profits abroad with interests will consequently lower the effective tax rate for FQM as a whole in case the interests are paid to a lower tax jurisdiction. We were not able to track the recipient company of the intra-group interests. However, the finance company closest in the group structure is incorporated in Barbados, which offers 0.25–2.5% tax rate for some MNEs (Deloitte, 2015).

<sup>30</sup> See footnote 24 on the merger directive.



**Table 2**  
Essential Kevitsa figures 2011–2014.

FQM Finnish subsidiary	Revenue	Mining rights depreciation	Operating profit/loss <sup>a</sup>	Intra-gr. financial income <sup>b</sup>	Intra-group financial costs	Other financial costs	Group contribution	CIT costs	Profit/loss	Financial liabilities	Intra-group financial liabilities	Total equity	Total liabilities	Finnish tax loss estimate <sup>c</sup>	FQM Group equity ratio <sup>d</sup>
2011 (€ million)															
Kevitsa Mining Oy	3.7	0.0	2.0	1.7	2.3	0.0	0.0	0.0	1.3	34.3	34.3	−1.4	34.6	0.1	69%
FQM Kevitsa Holding No 1 Oy (consolidated) <sup>e</sup>	0.0	0.0	−13.8	37.1	60.9	35.0	0.0	0.0	−56.1	653.9	653.9	−59.7	696.8	3.3	
2012 (€ million)															
Kevitsa Mining Oy	1.3	0.0	0.9	0.4	0.0	0.0	0.0	0.0	1.3	34.7	34.7	−0.2	34.8	−0.1	71%
FQM Kevitsa Holding No 1 Oy (consolidated) <sup>e</sup>	84.3	4.5	6.6	13.5	30.9	1.5	0.0	0.0	−16.8	837.2	837.2	−76.5	867.9	2.5	
2013 (€ million)															
Kevitsa Mining Oy	1.2	0.0	0.5	0.8	0.7	0.0	−0.8	0.0	−0.2	33.5	33.5	−0.3	33.8	0.0	52%
FQM Kevitsa Holding No 1 Oy (consolidated) <sup>e</sup>	130.6	9.3	2.5	50.6	38.8	5.7	0.8	0.0	2.1	865.7	865.7	−74.5	897.7	−1.2	
2014 (€ million)															
Kevitsa Mining Oy	1.2	0.0	0.5	0.0	2.6	0.0	2.2	0.0	0.1	30.1	30.1	−0.3	36.2	0.3	50%
FQM Kevitsa Holding No 1 Oy (consolidated) <sup>e</sup>	164.4	11.7	37.7	67.7	148.8	2.1	−2.2	0.0	−59.4	924.1	924.1	−133.9	954.3	8.1	
Total	386.8		36.8	171.7	284.9	44.3	0.0	0.0	−127.7					12.9	

The figures are based on the Finnish financial accounts prepared according to the Finnish GAAP (but see "d"). The Finnish CIT is calculated according to the Finnish GAAP.

<sup>a</sup> Mining rights depreciation not included, since it is not necessarily tax deductible (see Section 5.2.2).

<sup>b</sup> The source of the financial income is not specified on the accounts. There are no financial assets in Finland, which indicates the income should not be interest. Nearly all of the financial income is intra-group since 2012. FQM Kevitsa Holding No 1 Oy other financial income €16.5 million in 2011.

<sup>c</sup> Includes only estimated tax losses due to thin capitalization due to the difficulties in the estimation of other tax effects (see Section 5.2.2). The estimate is based on net intra-group finance costs, Finnish 20% tax rate in 2014 and the difference between equity ratio (negative each year = 0%) in Finland and the FQM's consolidated equity ratio. The 2014 tax rate is used for all years since FQM was not liable for tax before 2014. Formula: intra-group financial costs less financial income x equity ratio difference (%) x Finnish CIT rate 2014 (20%).

<sup>d</sup> The ratio was calculated based on the FQM's consolidated annual reports' figures by dividing the total shareholder's equity with total liabilities and equity.

<sup>e</sup> FQM Kevitsa Holding No 1 Oy figures are based on consolidated sub-group accounts (see Fig. 2). They include Finnish FQM Kevitsa Holding No 1 Oy, FQM Kevitsa Holding No 2 Oy, FQM Kevitsa Mining Oy, FQM FinnEX Oy and a Swedish Kevitsa Mining AB. The Swedish subsidiary has no significant effect on the consolidated figures as it is a sub-group holding company with no significant transactions or assets outside the group. The revenue represents ore sales of Kevitsa. Commercial production began only in August 2012. FQM Kevitsa Holding No 1 Oy income tax €2,6 million according to the Finnish Tax Administration data base. No income tax costs on financial statements.

holding company that used intra-group loans to purchase shares in the mining business in an intra-group restructuring. The latter structure was made possible by the Finnish group contribution regime, which allowed FQM to offset the losses of the holding company with the profits of mining business. (3) In addition, FQM acquired mining rights to Finnish subsidiary in an intra-group arrangement where it gained tax-deductible depreciations and amortizations. The Swedish subsidiary that sold the rights also avoided capital gains tax in Finland. (4) Finally, FQM used a Swedish holding company to avoid the Finnish dividend tax at source and the transfer tax if the mine is sold.

### 5.3. The FQM (Inmet) Pyhäsalmi mine: tax planning by structuring foreign investments

#### 5.3.1. Description of the Pyhäsalmi mine

Located in central Finland, Pyhäsalmi is a copper and zinc mine originally founded by Outokumpu Plc, which had exploited the upper part of the deposit from 1962 until its depletion in 2001. In 1996, Outokumpu discovered another deeper deposit and began mining operations there in July 2001. The lower part is expected to deplete by 2019. In March 2002, Outokumpu sold the mine to the Canadian Inmet Mining Corporation (Inmet) for €63 million. Out of this sum, €45 million was paid in cash, €14 million with a promissory note, and €4 million in Inmet shares (Inmet, AR 2002). Finally, FQM acquired Inmet in a hostile takeover in March 2013. With a total purchase price of \$4818 million, FQM also gained ownership of two other mines in Spain and Turkey and a mine development project in Panama (FQM, AR 2013). After the acquisition, FQM is able to offset losses in Kevitsa against the profits in Pyhäsalmi. The Pyhäsalmi mine employed 232 people in 2014, and the total sales revenue for the year was €148 million. The operating profit varied between €56 and €98 million, with an operating margin of 38–57% in 2011–2014. The annual ore production and sales have remained relatively stable (see Table 3).

#### 5.3.2. Tax planning arrangements

In July 2001, when Outokumpu began exploiting the lower deposit, the operations started under a newly established subsidiary, Pyhäsalmi Mine Oy. When Inmet acquired the mine in March 2002, the shares of Pyhäsalmi Mine Oy were entitled to FQM's new Finnish subsidiary, Inmet Finland Oy, directly owned by the Canadian parent company (see Fig. 3). Pyhäsalmi Mine Oy's shares were valued at €33 million on the 2002 balance sheet of Inmet Finland Oy. Initially, most of the financing needs of Inmet Finland Oy were served by an intra-group loan worth €46 million. The annual intra-group interest costs were €3–6 million until 2005 (see Table 3). Moreover, in August 2005, Inmet acquired a 70% interest in the Spanish Cobre las Cruces mining project from MK Resources Company (Inmet Finland, FS 2006). From a business perspective, the acquisition was separate from the Pyhäsalmi project. However, the way in which Inmet structured the acquisitions had significant effects on the Finnish CIT paid for the Pyhäsalmi's mining profits (see Fig. 4).

#### 5.3.3. The impact of arrangements

First, Inmet incorporated a Swedish holding company, Inmet Sweden Holdings AB, which then acquired Inmet Finland Oy's shares from its Canadian parent in 2006. The Swedish participation exemption regime allows Inmet to repatriate the Finnish mining profits to Canada with no withholding tax (see Section 5.2). Second, the Finnish interest costs rose dramatically as the shares of the Cobre las Cruces project were transferred to Inmet Finland Oy. This was done indirectly through two Dutch subsidiaries in 2005 and 2006, respectively (Inmet Finland Oy, AR 2006). Again, the acquisitions were funded primarily with intra-group loans. As a result, the total amount of Inmet Finland Oy's loans increased to €116 million in 2006, which generated yearly tax-deductible intra-group interest costs in Finland up to €10–15 million between 2006 and 2010 (see Table 3).

In the meantime, the mining operations at Pyhäsalmi remained extremely profitable, and Pyhäsalmi Mine Oy transferred these profits to Inmet Finland Oy as group contributions (see Table 3). However, the profits were not used for investments or loan repayments. Instead, each year, Inmet Finland Oy paid out nearly all profits as dividends, thus maintaining its poor solvency and high tax-deductible interest costs. Between 2006 and 2010, the total amount of dividends was €204 million, almost twice as much as the value of the intra-group loans (see Table 3). The Inmet group as a whole was mostly funded with equity instead of loans. The group's year-end equity ratio was between 56 and 90% in 2002–2012. In December 2010, Inmet acquired the remaining 30% of shares in the Cobre las Cruces project from MK Resources. The shares were initially assets of Inmet Sweden Holdings AB through a Dutch holding company. In early 2011, the shares were again sold to a newly established Finnish subsidiary, CLC Holdings Oy. The restructuring doubled Inmet Finland Oy's intra-group loans to €268 million (Inmet Finland Oy, AR 2011).

All intra-group loans after 2011 were issued by a Luxembourgian finance company, Inmet Finance Company S.à.r.l., which received a total of €37 million in interest income from Inmet Finland Oy in 2011–2014. The interest costs have been declining because of partial loan repayments and decreasing interest rates.<sup>31</sup> Inmet Finance Company S.à.r.l. was also used to finance the Cobre las Cruces project in Spain with loans arranged through two Dutch holding companies. The interest income helped the company generate a total profit of €116 million in 2010–2013, and it paid no income tax for these profits. Inmet Finance Company S.à.r.l. is in fiscal unity with a Luxembourgian branch of Inmet called Inmet Luxembourg, which has no significant business activity. Its total corporate income tax expenses were below €1 million in 2010–2013. Therefore, Inmet paid less

<sup>31</sup> The interest rate was fixed to Euribor for 3 months.

**Table 3**

Essential Pyhäsalmi figures 2002–2014 (€ million).

Year	Revenue (PM Oy)	Operating profit (PM Oy)	Group contribution to Inmet Finland Oy (PM Oy)	CIT costs Finland (PM Oy)	Net profit (PM Oy) <sup>a</sup>	Intra- group interest costs (IF Oy) <sup>b</sup>	CIT costs Finland (IF Oy)	Net profit/ loss (IF Oy) <sup>c</sup>	Dividend paid (IF Oy)	Finnish tax loss due to interest costs <sup>d</sup>	Finnish tax loss due to no withholding tax on dividend <sup>e</sup>	CIT/ Revenue (%)	CIT/PM Oy operating profit (%)	Equity ratio of Inmet/ FQM <sup>f</sup>	CIT rate Finland
2002	51.8	8.1	0.0	0.3	0.0	3.5	0.0	-1.2	0.0	0.7	0.0	0.5%	3.2%	69%	29.0%
2003	54.7	11.4	4.9	1.0	2.4	4.3	1.4	4.7	0.0	0.8	0.0	4.4%	21.2%	64%	29.0%
2004	72.1	26.2	19.6	0.1	0.6	4.3	5.3	12.9	1.9	0.7	0.1	7.5%	20.6%	59%	29.0%
2005	87.9	43.3	36.0	0.6	1.1	5.7	8.7	24.7	0.0	1.0	0.0	10.5%	21.4%	67%	26.0%
2006	146.6	96.8	91.0	0.5	1.0	12.2	21.3	60.5	28.0	2.2	1.4	14.9%	22.5%	70%	26.0%
2007	143.7	93.3	92.0	0.5	0.8	15.1	20.1	57.2	70.0	2.7	3.5	14.3%	22.1%	68%	26.0%
2008	121.1	58.5	55.0	1.4	3.4	13.5	10.8	30.5	58.0	2.3	2.9	10.1%	20.8%	66%	26.0%
2009	93.5	36.5	32.0	1.0	2.4	10.5	5.4	15.4	30.0	2.1	1.5	6.9%	17.6%	77%	26.0%
2010	152.5	86.4	82.0	0.9	1.9	9.2	18.7	53.3	16.7	2.0	0.8	12.8%	22.7%	84%	26.0%
2011	169.9	97.1	95.0	2.5	2.9	13.6	21.0	59.7	53.3	3.2	2.7	13.8%	24.2%	90%	26.0%
2012	159.4	82.9	79.0	1.9	2.3	10.3	17.0	52.3	25.0	1.4	1.3	11.8%	22.8%	56%	24.5%
2013	152.9	67.1	63.0	1.9	2.1	6.8	13.9	42.8	181.4	0.9	9.1	10.3%	23.5%	52%	24.5%
2014	147.6	56.6	65.0	1.5	2.3	6.7	12.2	48.8	129.9	0.7	6.5	9.3%	24.2%	50%	20.0%
Total	1553.8	764.2	714.5	14.0	23.3	115.6	155.7	461.6	594.2	20.7	29.7	10.9%	22.2%		

The figures of Pyhäsalmi Mine Oy (PM Oy) and Inmet Finland Oy (IF Oy) are based on Finnish financial accounts prepared according to the Finnish GAAP. The figures from 2002 to 2003 are from the original financial statements. Other figures are fetched from the Orbis database. Inmet/FQM has had a third subsidiary called CLC Holdings Oy in Finland since 2011. The subsidiary has not had significant income or costs.

<sup>a</sup> Total net finance costs of PM Oy in 2002–2014 were €9.4 million. There are also minor differences between tax and accounting depreciations.

<sup>b</sup> Most of the financial costs are intra-group interests. No significant financial income.

<sup>c</sup> IF Oy was a holding company with no operating business activity (total net operating profit €0.1 million in 2011–2014).

<sup>d</sup> The formula for calculating the tax losses: IF Oy intra-group interest costs x Finnish CIT% x Inmet/FQM equity ratio.

<sup>e</sup> The withholding tax had been five percent, if it had been paid directly to a Canadian parent company (see Section 5.3.3).

<sup>f</sup> The ratio was calculated by dividing the total shareholder's equity with total liabilities and equity. The 2003–2012 figures are based on the Orbis database. The 2002 figure was calculated based on Inmet annual report and the figures for 2013–2014 are based on the FQM's annual report as FQM acquired Inmet in 2013.

than one percent income tax for the profits it generated in Luxembourg. What is more, Inmet managed to gain these tax benefits with no employees in the country (Inmet Finance Company S.à.r.l., FS 2010–2013; Inmet Luxembourg, FS 2010–2013).

The acquisition of the Pyhäsalmi mine turned out to be a major success. In 2002–2014, its sales were €1554 million, with an operating profit of €764 million, which can be compared to the acquisition cost of less than €70 million (see Table 3). During the same period, Inmet Finland Oy paid out €594 million in dividends and €116 million in intra-group interests that reduced the CIT. The interest costs reduced Finland's tax income by roughly €20 million, which accounted for 12% of the €170 million total CIT paid in Finland (see Table 3). Moreover, Finland received no withholding tax income from the dividends since these were paid through the Swedish holding company. Had the dividends been paid directly to the Canadian parent instead, Finland would have received a withholding tax income of €30 million according to the five percent rate in the tax convention (Art. 10) between the two countries (see Table 3).

We maintain that the majority of the tax losses resulted from artificial arrangements since Inmet had no employees in Sweden and the cash flow from mineral sales would have sufficed to finance the Pyhäsalmi mining operations. Because of the interest expenses, the aggregated effective tax rate from the Pyhäsalmi operations was just 22% in 2002–2014, a period during which the Finnish tax rate was gradually lowered from 29% to 20% in 2014 (see Table 3). Inmet's 2011 Annual Report (p. 31) supports this observation by stating that in Pyhäsalmi, 'tax recovery from intergroup loans' has lowered its effective tax rate to three percent below the Finnish statutory rate in 2010 and 2011. Similar arrangements at the Cobre las Cruces mine have resulted in even more dramatic results as the effective tax rate in Spain decreased by 15% in 2011 and by 22% in the previous year. Out of the variety of tax arrangements employed by FQM, the thin capitalization structure at the Pyhäsalmi mine is the closest to a textbook example on how large enterprises are able to differentiate their value chains from their wealth chains, not least because the questionable tax incentives granted by Luxembourg (European Commission, 2015a; Marian, 2016b).

#### 5.3.4. Summary of the tax avoidance arrangements

Inmet employed five tax planning techniques at the Pyhäsalmi mine. First, it made three separate arrangements to thin capitalize the Finnish mining business. (1) It used intra-group loans to finance the mining investments; (2) it set up a holding company, which used intra-group loans to purchase shares in the mining business in an intra-group restructuring; and (3) it used intra-group loans to finance separate investment in Spain. The Finnish group contribution regime allowed it to offset the losses of the holding company with the profits of the mining business. (4) Moreover, Inmet acquired the mining rights to Finnish subsidiary in an intra-group arrangement where it gained tax-deductible depreciations and amortizations. The

Swedish subsidiary that sold the rights also avoided capital gains tax in Finland. Related to this, (5) Inmet used a Swedish holding company to avoid the Finnish dividend tax at source and the transfer tax, which is payable if the mine is sold.

#### 5.4. The AE Suurikuusikko mine: tax planning by thin capitalization and a Swedish holding company

##### 5.4.1. Description of AE and the Suurikuusikko mine

Agnico Eagle Mines Ltd. (AE) is a Canadian gold and silver company listed in the Toronto and New York stock exchanges. It operates eight mines in Canada, Finland, and Mexico. The Suurikuusikko gold deposit was discovered in 1986 by the National Geological Survey of Finland, which began developing the project. In 1997, the Finnish government held an auction for the mining rights. Riddarhyttan Resources AB, a newly established exploration company listed in the Stockholm stock exchange, won the auction and continued developing the project. The sale price was €0.2 million, and Riddarhyttan Resources AB agreed to pay a two percent royalty based on the revenue less processing costs (AE, AR 2013). The royalty agreement also binds Riddarhyttan Resources AB's successors in Suurikuusikko after the first year of production. Suurikuusikko was the only significant asset of Riddarhyttan Resources AB when AE purchased a 14% minority share in the company in 2004. In 2005 and 2006, AE completed its first foreign acquisition by acquiring the remainder of the Riddarhyttan Resources AB shares with 10,023,882 of its own shares and \$5 million in cash. AE finalized the development and began commercial production at Suurikuusikko in 2009. The mine is expected to operate until 2036.

##### 5.4.2. The tax planning arrangements

The Canadian parent company initially owned the shares in Riddarhyttan Resources. However, in November 2005, AE set up a Swedish holding company, Agnico-Eagle Sweden AB, which purchased the shares from its parent for SEK 1335 million (€145 million). Simultaneously, Riddarhyttan was delisted from the Stockholm stock exchange. At the time of the acquisition, Riddarhyttan Resources AB's Swedish subsidiary Agnico-Eagle AB owned the Suurikuusikko mining rights, and its permanent establishment in Finland began the mining activities in 2009. In early 2010, AE transferred the mining business to a new Finnish subsidiary called Agnico-Eagle Finland Oy. Moreover, the corporate and finance structures went through a major reorganization (see Fig. 5). Agnico-Eagle Sweden AB's shares were transferred to a Dutch cooperative, Agnico-Eagle Mines Sweden Coöperatie U.A., which was founded in late 2009. Since then, the cooperative has granted intra-group loans to fund mining investments in Finland. In addition, AE established a finance subsidiary in Barbados, which lends the cooperative funds for financing business in Finland (Agnico-Eagle Mines Sweden Coöperatie U.A., FS 2011–2013). These restructurings created two tax consequences.

##### 5.4.3. The impact of the arrangements

The Swedish participation exemption regime enables AE to repatriate profits from Finland to Canada without paying any withholding tax (see Section 5.2). Because of this, AE was able to avoid €3 million of dividend withholding tax in Finland. Since 2010, Agnico-Eagle Finland Oy has been financed primarily with loans from the Dutch cooperative. The loans totaled €224 million at the end of 2010 and increased to €318 million by 2014. In the same year, Agnico-Eagle Finland Oy paid out €46 million in dividends. In the period 2011–2014, the yearly intra-group interest costs amounted to €18–22 million (Agnico-Eagle Finland Oy, FS 2011–2014).<sup>32</sup> According to Dutch law, cooperatives are not entitled to pay taxes on interest income (Blom & Viëtor, 2009). The equity ratio of Agnico-Eagle Finland Oy was 32% at the end of 2014. In comparison, the AE group relied on equity financing with a rather high consolidated equity ratio of 59% at the end of 2014 (AE, AR 2013). The situation has remained similar since 2009 (see Table 4). Therefore, we maintain that the arrangement aimed to lower AE's tax burden. We estimate that the thin capitalization-related tax savings totaled €10 million in the period 2009–2014. Without financial records from Barbados, we could not assess whether AE paid taxes there. However, in the case it has paid any taxes in Barbados, the tax rate has likely been low due to tax incentives.<sup>30</sup>

Since the beginning of 2009, Agnico-Eagle Finland Oy's operations in Suurikuusikko have been highly profitable. The total sales revenue was at its peak, €190 million, in 2013, decreasing to €138 million a year later. In 2011–2014, the operating profit varied between €14–96 million while the operating margin was 10–42%. However, loan arrangements, depreciations and amortizations from initial investments exempted the company from paying taxes in Finland until 2012. Altogether, AE has paid a CIT of €18 million in Finland out of an operating profit of €265 million in the period 2010–2014 (see Table 4).

The separate entity doctrine grants MNEs much freedom to design the capital structure of their individual investments. They can do this regardless of their external funding needs and consolidated group capital structure by using internal finance companies to channel the funding (Feld, Heckemeyer, & Overesch, 2013). Instead of using external debt funding AE used a low tax Dutch cooperative and a Barbadian finance company to fund the Finnish operations. Nevertheless, the AE group companies were in joint liability for the group's external funding (e.g., Agnico-Eagle Finland Oy, FS 2011–2013), but the equity ratio in Finland was approximately half compared to the ratio of the AE group in the period 2009–2014.

<sup>32</sup> The interest rate of the loans has been fixed at 7.42%, which can be compared to the rates of 4.87–6.67% in unsecured bonds that the AE group has offered to third parties.

#### 5.4.4. Summary of the tax avoidance arrangements

AE employed two different tax planning techniques at the Suurikuusikko mine. First, it used intra-group loans to finance the mining investments. Second, AE used a Swedish holding company to avoid the Finnish dividend tax at source and the transfer tax, which is payable if the mine is sold.

### 6. Discussion and implications for further research

#### 6.1. Tax avoidance strategies

Having introduced the three case studies, in this section we discuss their significance. By combining financial data from various sources, we have answered calls to overcome the lack of information on tax shelters (Graham & Tucker, 2006: 565) and to incorporate a creative use of data sources (Hanlon & Heitzman, 2010: 157) in order to examine how accounting techniques re-allocate wealth (Sikka & Willmott, 2010: 353). Our article presents the first multiple case study on corporate tax planning that draws from a systematic industry-wide screening to select specific MNEs for closer examination. Moreover, we believe the findings open up new avenues for further research. The initial screening of financial statements of all mining companies operating in Finland gave us a clear indication for choosing the mines for closer examination.

The analysis of the three Finnish mines operated by First Quantum Minerals Ltd and Agnico Eagle Ltd revealed seven different tax arrangements that the Canadian MNEs utilized to lower their taxes in Finland (see Sections 4 and 5). Both of the enterprises resorted to thin capitalization with three different techniques. AE financed its investments in the Suurikuusikko mine with a rather typical intra-group debt arrangement from a low-tax jurisdiction. FQM employed a similar structure in its Kevitsa mine but was also able to un-capitalize its Finnish subsidiaries with a holding company that used intra-group debts to purchase shares in the mining business. In the Pyhäsalmi mine, Inmet and FQM were able to shift profits abroad by using a Finnish holding company for a separate mine investment in Spain.

Buettner, Overesch, Schreiber, and Wamser (2012: 930) maintain that the lack of studies on the effectiveness of thin capitalization rules is surprising. We share this sentiment and believe that our case studies can help to steer future research on thin capitalization.<sup>33</sup> Analyzing the nuances of thin capitalization arrangements is important from a tax policy perspective, as tackling different types of arrangements call for different types of legal measures. Traditional thin capitalization rules limiting the tax-deductible share of interest are generally sufficient to intervene with the traditional thin capitalization that AE used, which purely resorts to the excess use of debt funding for local investments (Blouin, Huizinga, Laeven, & Nicodème, 2014). However, FQM used also two different techniques to artificially create debt and consequently tax-deductible interests by (1) intra-group acquisitions and (2) shifting debts that financed separate investments in Spain to Finland. In these cases, the whole interest cost could be considered excess, since the debt was not used to finance the investment in Finland even though the interest costs reduced taxable profit there. Therefore, traditional thin capitalization rules that usually allow a deductible share of interest should be complemented with specific legislation to tackle these arrangements. One option for this would be disallowing the use of group relief in situations where it is used to exploit artificially created interest costs.

The importance of understanding the nuances also applies to intellectual property rights, which have been discussed in the context of 'research and development activity' (Dharmapala, 2008: 667) in the form of patents (Graham & Tucker, 2006: 573), trademarks (Rixen, 2010: 18), and other R&D related rights (Grubert, 2003) – but to the best of our knowledge not in relation to extractive industries. We were able to identify how mining concessions can be used to shift profits away from the location country of a mine (see Section 5.2.3). We also showed how the EU Parent-Subsidiary directive, which is meant to prevent economic double taxation within EU, in fact facilitates tax avoidance as it can also be used to channel profits outside the EU without paying a withholding tax by using Swedish holding companies.<sup>34</sup> Both of the Canadian enterprises used this technique.

Another striking feature regarding the tax avoidance arrangements in our case studies was the unimportance of low statutory corporate income tax rates in profit shifting destinations. Specific tax incentives in both Luxembourg and Sweden were used to minimize taxes as the statutory tax rates in these countries were close to the global average or even higher.<sup>35</sup> This finding is particularly important given that the dominant quantitative research tradition has largely relied on the presumption that differences in statutory corporate income tax rates are the driving force of tax avoidance. In next subsection we discuss how this brings into question the reliability of the empirical data in the quantitative tax avoidance research (see also Section 2.1).

The territorial tax system in Canada allowed AE and FQM to benefit from their tax avoidance abroad. If they had been based instead in the United States, the benefit would have diminished when the profits had been repatriated since the lower

<sup>33</sup> As for example, we believe that Finland would be an interesting case for quantitative studies as it introduced limitations on the deductibility of intra-group interests in 2014 (Business Tax Act, §18a).

<sup>34</sup> Similar 'participation exemption shopping' has been previously discussed in relation to the German tax regime (Broemel, 2016).

<sup>35</sup> The statutory rate in Luxembourg was 29.22% in 2014 and 22% in Sweden (KPMG, 2016). According to KPMG, the global average was 23.87%.



taxes abroad would mutually result in a lower tax credit from the taxes paid out from the dividends in the United States.<sup>36</sup> In a territorial system, such as that in Canada and all other developed countries, the profits of foreign subsidiaries and dividends paid out from them would be generally tax exempt. Previous quantitative tax research has not paid enough attention to the impact of the differences between the U.S. worldwide tax regime and the territorial tax regimes elsewhere.

## 6.2. Methodological issues

For the most part, the impact of tax avoidance has been studied quantitatively, using econometric methods. Our cases studies highlight several problems related to data and to the presumptions of these studies, bringing into question the reliability of the approach (see Section 2.1).<sup>37</sup> Much of this research makes presumptions about the role of statutory tax rates in tax avoidance, but we show that this is not the only consideration that matters within the field. We also suggest that the reliability of the data used in the studies is often questionable. Due to the lack of public data, quantitative research has tended to rely on databases that do not include information from many of the countries used in tax avoidance. In our case studies, we discovered that subsidiaries registered in countries such as Barbados and Luxembourg were used as profit shifting destinations. The financial statements of these subsidiaries were not included in the Orbis database, as is generally the case for any financial statements of local subsidiaries in these countries. The lack of data in this most widely used database for quantitative corporate tax research is not limited to secrecy jurisdictions, as financial statements of separate entities are usually not available anywhere outside Europe.<sup>38</sup> We could not retrieve the accounts of parent entities in Canada even when the enterprises were listed on the stock exchange there, because Canada only requires the publication of consolidated accounts. This lack of data was just one of the issues we discussed in Section 2.1, which reduces the reliability of research based on Orbis and other databases widely used in tax avoidance research.

In order to conduct generalizable research on tax avoidance, systematic selection of the research material and questions is of paramount importance. Previous qualitative case studies that have only covered individual enterprises and have drawn from sporadic datasets based on court cases or exposures in the media give very little grounds for generalization. We believe our approach helps to form a new methodological terrain, as this is the first qualitative case study on corporate tax avoidance that has been based on a systematic, industry-wide analysis of financial accounts. As such, we hope that the article paves way for further similar studies, and that it also helps to develop quantitative methodological approaches as we argued in the previous subsection.

## 6.3. Global wealth chains

Our qualitative research method provided detailed information on tax avoidance arrangements and allowed us to research tax avoidance in the context of the broader global political economy. Mine exploration is often conducted by separate enterprises that sell the rights to mining enterprises for further development, as demonstrated by our case studies. The location country of the mine might not tax the capital gain if the ownership of the mining rights has been entitled to a foreign company.<sup>39</sup> However, for example in Finland the purchasing enterprise is usually able to deduct the amortizations of the rights, if they are entitled to a Finnish subsidiary (OECD, 2014; Model Tax Convention, Art. 9; Business Tax Act, §24). This was evident in the Kevitsa case study, where we demonstrated how FQM could avoid Finnish capital gains tax by entitling the immaterial mining rights to a foreign subsidiary. This issue has not received sufficient attention in the legislation or tax treaties. Effectively, mining rights allow mining companies to separate their production chains (i.e., the mining and processing activities) from their wealth chains (i.e., where the concessions are booked).

This finding questions the traditional commodity-chain approaches where the 'relative distribution of wealth within a commodity chain often has been portrayed in the social sciences as reflective of levels in a hierarchy of production' (Gereffi & Korzeniewicz, 1994: 4). According to the commodity- and value-chain research tradition, production hierarchies became outdated with the rise of the new export-oriented and technology-intensive forms of production (Gereffi & Korzeniewicz, 1994: 4). However, our case studies illustrate a very traditional extractive industry operation where the 'value' seemingly produced in Finland was transferred artificially to Barbados, Luxembourg, the Netherlands and Sweden. This had little or nothing to do with the production process or other value creation which was illustrated by the fact that in some cases the

<sup>36</sup> However, the U.S. multinationals might receive a final tax benefit from tax avoidance abroad if the repatriated dividends would be temporarily exempted from U.S. income tax as Donald Trump promised during his presidential campaign. A similar 'repatriation holiday' was last enacted in 2004 during the George W. Bush administration (Gravelle, 2015).

<sup>37</sup> The reliability could also be questioned by the exceptional range of average semi-elasticities between tax rates and profits in individual countries. According to an extensive review by Heckemeyer and Overesch (2013: 29) this range of average semi-elasticities in previous studies has been 0.31–12.29. This means that a one percentage increase in the (statutory) tax rate difference between a subsidiary and its parent would increase the pretax profit of the subsidiary by 0.31–12.29%. Despite the huge range the sign of semi-elasticities has remained the same in dozens of studies, which denotes that lower tax rate increases pretax profits.

<sup>38</sup> E.g., Australia, India, Singapore and some others being exception to the rule.

<sup>39</sup> See Section 5.2 concerning Finland and the Nordic Tax Convention. However, a tax convention based on the OECD Model Tax Convention (Art. 6 & 13) could grant the taxing right to the location country, assuming that its national legislation permits this (Du Toit, 1999: 37).

case study enterprises did not have any employees in these countries.<sup>40</sup> As such, our case studies support the nascent research agenda around wealth chains within the ‘decentralized corporations’ (Desai, 2008) that can have separate ‘homes’ for their talent, financial operations and legal headquarters.

While value chains and production networks are characterized by relative transparency and coordination, actors in wealth chains thrive by the secrecy of the arrangements (Seabrooke & Wigan, 2014a: 257). Seabrooke and Wigan (2014a: 261) have called for ‘a clearer picture of how wealth chains have an impact on developed and developing countries’ and have similarly pressed for investigations into how far financial innovations characterize transfers through wealth chains. Noting how value chain research has focused on the disaggregation of production processes across countries, Seabrooke and Wigan (2014b) have called for more attention to the legal and financial disaggregation of enterprises. Our case studies are a prime example of this. A traditional value chain analysis of the Finnish mining industry would fail to highlight the important role played by Barbados, the Netherlands, Luxembourg and Sweden in channeling profits.

Seabrooke and Wigan have noted how tax avoidance ‘occurs at the intersection between variegated national tax systems’ (2014a: 258). While agreeing on the importance of these intersections, we propose more attention should be paid to the general principles behind international tax legislation, namely the arm’s length principle and the separate entity doctrine. These principles play key roles as the underlying structure enabling multinational enterprises to benefit from commercialized sovereignty, which allows tax havens to facilitate tax avoidance (Avi-Yonah, 1995; Durst & Culbertson, 2003; Eden, 2016; Fichtner, 2016; Palan, 2002; Picciotto, 1992; Rixen, 2010).

Many of the tax-avoidance related distortions in the global wealth chains can be traced back to the conflict between the separate entity doctrine on the one hand and the unitary nature of the business operations of MNEs on the other (Picciotto, 2016a). We argue that the power to apply the doctrine enables corporate tax avoidance. Indeed, all of the tax arrangements we described in our case studies were made possible by the separate entity doctrine that allows a MNE to use its individual subsidiaries as tax avoidance vehicles (Ting, 2014: 71; see also Avi-Yonah & Benshalom, 2011; Cockfield, 2004). However, we also highlighted how enterprises can offset one subsidiary’s profits with losses from another by using group reliefs, thus effectively overriding the separate entity principle for their own purposes.<sup>41</sup> These different applications result in very different divisions in tax revenues. In other words, the enterprises have excessive powers to operate as separate entities when it suits them for tax purposes, while planning their operational supply chains as an integrated entity.

Separate entities within an MNE are fictional, underlined by the fact that professional investors or analysts view a corporate group under one parent company as a single enterprise (Commons, 1957; Graham, 2003).<sup>42</sup> To illustrate this, all Finnish subsidiaries analyzed in the case studies were in joint liability for debts that foreign group companies had taken from outside lenders (see, e.g., FQM Kevitsa Holding No. 1 Oy, FS 2013; Agnico-Eagle Finland Oy, FS 2013; Pyhäsalmi Mine Oy, FS 2013). We argue that the main reason for this was that these arrangements reduced the MNEs’ overall financial costs. Many of these group companies were holding companies with no real business activity.

The role of holding companies has mostly been discussed in the context of tax havens (e.g., Desai et al., 2005). However, we illustrated how Sweden is used as a hub for repatriating profits to avoid dividend tax at source. This also illustrates how global wealth chains often differ significantly from global value chains or production networks. The key discrepancy that gives MNEs this power is that whereas a legal corporation exists only in formally, ‘an economic going concerning existing wherever it does business’ (Commons, 1934: 55).

In the introduction, we noted how the separate entity principle is closely connected to another key principle of international tax governance, namely the arm’s length principle. The concept is highly ideological (Ylönen & Teivainen, 2015), because of the false impression it conveys on the possibilities of finding ‘markets’ inside large enterprises. Our case studies highlight how the application of the arm’s length principle in the pricing of finance and intangible mining rights can result in substantially different portioning of profits even in an industry where the business itself is highly tangible.

The case studies also allowed us to analyze ways corporations exert power over states in the global economy (Dillard & Vinnari, in press: 14). This growth of corporate power can be conceptualized using the distinction between voluntary and volitional freedom. Originally developed by the evolutionary economist and legal scholar John Lee Hale in the early 20th century (Fried, 1998; Hale, 1935; Hale, 1952; Samuels, 1972: 277), the voluntary-volitional continuum distinguishes between the circumstantially limited exercise of choice between alternatives or behavior (i.e., voluntary freedom) and complete autonomy with the absence of constrained choice or limits to choice or behavior (i.e., volitional freedom). While volitional freedom is commonly associated with governmental use of power, Hale noted already in the 1920s how private enterprises could also enjoy this kind of freedom. Our case studies are illustrative examples of this. Viewed from this angle, property can be conceptualized as something that ‘provides the capacity to exercise coercive’<sup>43</sup> impact upon others and the correlative

<sup>40</sup> These findings also undermine the simplistic ideas of efficient international allocation of resources by reducing national and international regulation (Dorn, 1993). While this sort of ‘trickle-down economics’ is no longer in the academic mainstream, it still has a considerable influence in public discussion.

<sup>41</sup> An obverse example is the ‘ring fencing’ legislation adopted in some other jurisdictions that restricts offsetting the profits and losses of separate mines even within an entity. Essentially, this legislation extends the state’s capability to tax separate businesses separately.

<sup>42</sup> Another factor behind the failure of the separate entity doctrine is more methodological. There are no methods to determine equivocal transfer prices because there are no decent benchmarks available. Business-to-business transactions are dealt in confidence and are not usually available for benchmark purposes. Intra-group transactions are also often performed in conditions that do not occur between independent enterprises, and therefore, benchmarks could not exist even theoretically (see also Avi-Yonah & Benshalom, 2011: 378–380; Ylönen & Teivainen, 2015).

<sup>43</sup> Hale and Samuels use the word ‘coercive’ in a non-pejorative sense.

ability to withstand the coercive capacity of others' (Hale, 1935: 150; Samuels, 1972: 305). This can be illustrated, for instance, with the case where FQM was able to treat the mining concessions in Finland as immaterial rights and transfer them to Sweden, effectively withstanding the capacity of Finland to tax its future income.

#### 6.4. Other issues

Our case studies point to the institutional factors behind tax avoidance. The aggregated data collected from the 12 Finnish metallic ore mines showed that the mines generated only €92 million of tax income for Finland in the period 2011–2014, all of which was paid by the Kevitsa, Pyhäsalmi and Suurikuusikko mines, the focus of the case studies (see Table 1). This amounted to 0.5 of the total CIT revenue of €18.5 billion (Finnish Tax Administration, 2015b). Alternatively, the taxes accounted for 2.4% of the companies' total mineral ore sales of €3861 million in 2011–2014. Conversely, the direct state support to the mining enterprises was €22 million in the period 2000–2011. In the same period, government agencies also invested roughly €300 million in the mining business (Ministry of Employment and the Economy, 2012: 34–35).<sup>44</sup>

As a conclusion of these figures, subsidizing the mining industry with a favorable legislation has generated only negligible revenues for Finland despite the substantial ore volumes worth billions of euros. While it is difficult to pinpoint the exact reasons for this failure, it is evident that Finland failed to ensure contributions to local communities when it amended its mining laws in 2011. Tax avoidance concerns were not discussed during the legislative process. Moreover, we noted how the Ministry of Employment and the Economy commissioned a consultancy study that was favorable toward introducing a mining royalty legislation, but the study was curiously never published. As a result of these factors, the decision to abstain from establishing mining royalties likened Finland to developing countries that aim to compensate for their unstable business environment by lowering their mining taxes (Ericsson & Farooki, 2012). We find three possible, but not necessarily mutually exclusive, reasons for this failure. First, the new Mining Act clearly favored the mining industry (Frazer Institute, 2015), and even the minister responsible for the drafting process admitted the strong impact of corporate lobbying on the final wordings of the law (Yle, 2009). This factor calls for additional interdisciplinary research on the politics of tax planning (Sikka & Willmott, 2010: 353).

Second, the corporate sector attracts some of the best tax professionals, giving the lobbyists an upper hand over civil servants and politicians. Specifically, the 'complexity of the calculative practices that institutions undertake to enable transformative action' enables mining enterprises to influence the tax system, especially when the parliamentarians generally have limited knowledge on accounting details and the fundamentals of an individual industry (Stoianoff & Kaidonis, 2005: 50). This factor requires more research on the role of professionals in facilitating tax-driven wealth chains (Seabrooke & Wigan, 2014a). The accounting and tax systems should serve society, but in practice some tend to benefit over others (Johnston, 2015: 99). Third, the general lack of research on best practices in mining tax policy also hinders fact-based discussions on how to design mining sector taxes. As Clausing and Durst (2015: 13) have noted, 'there appears to be no literature comparing the administrative success of different kinds of fiscal regimes in practice' (see also Laporte & De Quatrebarbes, 2015: 11–12).

All of these factors highlight the need to question straightforward comparisons between governments resources and capabilities when it comes to taxing multinationals. They illustrate how the low mining sector taxes resulted from legislative deficiencies and not from inadequate administrative resources. This challenges the idea that adequate resources would ensure the appropriate collection of taxes and hints that there is much potential in the recent turn from the Washington Consensus policies toward a renewed 'resource nationalism' in many developing countries (Bakir, 2015; Haslam & Heidrich, 2016). Indeed, Finland was ranked as the most attractive jurisdiction for mining investment in the world in 2014 precisely because of its mineral policy and political climate, which placed it ahead of more mineral-rich nations (Frazer Institute, 2015: 8–13).

Turning to more policy-related recommendations, we argue that the main tax attraction of Finland for mining enterprises is not a low corporate tax rate but the opportunities for avoiding taxes. This avoidance is facilitated not only by the interplay between the legislation of Finland and the MNEs host countries, but also by third countries that offer incentives for holding and finance subsidiaries.<sup>45</sup> Introducing a mining royalty regime would be the most straightforward option since individual countries have to secure their rents when ores are being mined (Guj, 2012). *Ad valorem* mining royalties are generally regarded as effective to administer as they are based on sales prices, and there is no need to calculate and attribute costs (Guj, 2012: 14). A royalty legislation would also encourage companies to favor potentially more profitable projects, thus decreasing the risk of loss-making projects where ores are mined without any CIT left in the country (for further discussion, see, e.g., Guj, 2012).

#### 6.5. Limitations and pathways for future research

This article is not without limitations. Much of the details about corporate tax practices are outside of the public domain, both because of commonly accepted business secrecy as well as the fact that much of tax planning thrives from additional

<sup>44</sup> Since then, the troubles of the now bankrupt Talvivaara mine have accounted for a few hundred million euros owing to the government (Kankare, 2015).

<sup>45</sup> E.g., Altshuler and Grubert (2003) and Killian (2006) have discussed the interplay between the laws of home and host governments.



**Table 4**

The essential figures of the Suurikuusikko mine 2009–2014 (€ million).

Year	Revenue	Operating profit	Additional depreciation <sup>a</sup>	Net finance costs <sup>b</sup>	Group contribution to Oijärvi Resources Oy <sup>c</sup>	CIT costs Finland	Net profit	Dividend paid	Finnish tax loss due to interest costs <sup>d</sup>	Finnish tax loss due to no withholding tax on dividend <sup>e</sup>	CIT/Revenue (%)	CIT/Operating profit (%)	Equity ratio Finland <sup>f</sup>	Equity ratio of AE <sup>g</sup>	CIT rate Finland
2009	44.0	0.9	10.6	10.4	0.0	0.0	–20.1	0.0	1.4	0.0	0.0%	0.0%	28%	65%	26.0%
2010	68.8	19.6	12.9	8.8	0.0	0.0	–2.1	0.0	1.2	0.0	0.0%	0.0%	30%	67%	26.0%
2011	163.2	57.2	18.6	18.3	0.0	0.0	20.3	0.0	2.2	0.0	0.0%	0.0%	34%	64%	26.0%
2012	184.4	96.3	20.3	18.8	4.3	6.5	46.4	0.0	2.0	0.0	3.5%	6.7%	38%	65%	24.5%
2013	190.2	76.9	13.9	16.7	0.0	11.7	34.5	46.0	1.4	2.3	6.2%	15.2%	39%	60%	24.5%
2014	138.3	14.5	22.9	21.9	0.0	–0.1	–30.2	8.9	1.7	0.4	–0.1%	–0.7%	32%	59%	20.0%
Total	788.7	265.4	99.3	94.9	4.3	18.1	48.8	54.9	10.0	2.7	2.3%	6.8%			

The figures from 2010 to 2014 are based on the financial accounts of the Agnico-Eagle Finland Oy prepared according to the Finnish GAAP. The figures from 2009 are based on the financial account of the Agnico-Eagle AB as the Swedish company began the mining operations in 2009. (see Section 5.4) The original figures in SEK have been converted to EUR according to the year-end average exchange rate (1 EUR = 10.2520 SEK).

<sup>a</sup> The additional depreciation to accounting depreciation is made according to the Finnish tax legislation.

<sup>b</sup> Finance costs less finance income. Most of the costs are intra-group interests.

<sup>c</sup> Oijärvi Resources Oy offset its losses from exploration activities against Agnico-Eagle Finland Oy taxable mining profits before the companies merged in 2013.

<sup>d</sup> Tax losses calculated based on net finance costs, Finnish tax rate and difference between the AE's equity ratio in Finland and the AE's consolidated equity ratio.

<sup>e</sup> The withholding tax had been five percent, if it had been paid directly to a Canadian parent company (see Section 5.3.3).

<sup>f</sup> The ratio was calculated by dividing total shareholder's equity with total liabilities and equity. The total additional depreciations were included in equity.

<sup>g</sup> The ratio was calculated by dividing the total shareholder's equity with total liabilities and equity. The figures are based on AE's consolidated annual reports.

layers of secrecy granted by tax havens. For an example, we were not able to obtain financial accounts from Barbados. Moreover, the gap between taxable and financial income is not explicitly expressed in Finnish financial statements, which made assessing the exact tax implications impossible. This limitation mainly involved depreciations and amortizations that are often calculated differently in taxation and accounting in Finland (Business Tax Act, Section 3). Furthermore, the mines were at different stages of production, which limited possibilities to assess tax planning. Estimating the impact of tax planning for the Kevitsa mine was particularly difficult as it had not generated any CIT before 2014. In contrast, Pyhäsalmi was already in a stable phase of production, which made it relatively easy to calculate the impact of tax planning.<sup>46</sup>

While we were able to create a rather reliable picture of the tax structures employed at Finnish mines, we could not assess the division of risk between the related companies and other contractual provisions. These factors affect the arm's length transfer prices that could have been used in profit-shifting since there were substantial intra-group ore sales and interest costs (OECD, 2010). However, information of this kind is confidential and was therefore out of the scope of this study.

There are also two broader issues that weaken the reliability of the research data, thus potentially affecting the conclusions made. First, we do not know for sure whether the Finnish Tax Administration has challenged the legality of the arrangements.<sup>47</sup> However, we found no evidence of this, and major disputes would have been reported in the financial accounts (See for example FQM, AIF 2014: 117–119). Second, a third country could have taxed the income discussed in the case studies when resident or source countries failed at this, based for example on the parent company's resident country's controlled foreign company regime (see, e.g., Lang, Scheuerle & Stefaner, 2004). Alternatively, a subsidiary registered in, Luxembourg or some other country could be deemed a resident in another country for CIT purposes (OECD, 2014; Model Tax Convention, Art. 4). However, there was not sufficient financial information available to assess this because only consolidated accounts of listed companies were available from Canada.

These limitations highlight the need for the provision of more transparent and comprehensive financial information. One solution for this would be requiring enterprises to publish their key financial items on country-by-country basis (Australia Senate Economics References Committee, 2015: 80; Murphy, 2016). Moreover, considering the considerable freedoms that large enterprises enjoy in designing their wealth chains, there is a need for a wider discussion on the role of corporate secrecy in 21st century capitalism. Corporations exert financial power over states with their tax planning arrangements, and both governments and large enterprises should be transparent on the details of these arrangements. Despite the recent policy-level interest toward tackling corporate tax avoidance, these considerations have not received sufficient attention.

<sup>46</sup> With Pyhäsalmi and Suurikuusikko, we were also able to double-check our calculations as the total amount of taxable income and tax are public information in Finland. This does not reflect the tax losses.

<sup>47</sup> The tax administration could challenge arrangements within six years after the financial year, if it is considered that they were not conducted on an arm's length basis or that they should be classified as tax avoidance as defined in the Finnish general anti-avoidance rule (Act on Assessment Procedure, 18.12.1995/1558, §28, 31 and 55–56).

## 7. Concluding remarks

Our article has made a step in analyzing wealth chains and their underlying principles ‘in the real world’, thus addressing gaps in the existing body of literature on mining taxation, corporate tax avoidance and its societal impact. Regarding further research along these lines, we maintain that information leaks, such as the ‘Lux Leaks’, could provide useful material for tax and accounting research (e.g. [Marian, 2016a](#)). Another option might be to turn to enterprises or tax authorities and ask them to provide confidential, anonymized data (see, e.g., [Ali-Yrkkö & Rouvinen, 2015](#)). The separate entity principle based on arm’s length transfer pricing is broken and needs to be fixed. We doubt that the ongoing policy efforts by the OECD will be able to fix the underlying problems as they continue to rely on the arm’s length principle and the separate entity doctrine ([OECD, 2015b](#)). A well-designed formulary approach could help remedy these problems ([Avi-Yonah & Benshalom, 2011](#); [Picciotto, 2016b](#); [Siu, Picciotto, Mintz & Sawyerr, 2015](#)), as the European Commission (EC) has suggested in its Common Consolidated Corporate Tax Base directive proposals (COM(2016) 685 final; [Cerioni, 2016](#)).<sup>48</sup>

We want to underline that the division of potential tax incomes is one of the most fundamental questions in contemporary capitalism. The governments of countries where value creation actually takes place should be in the position

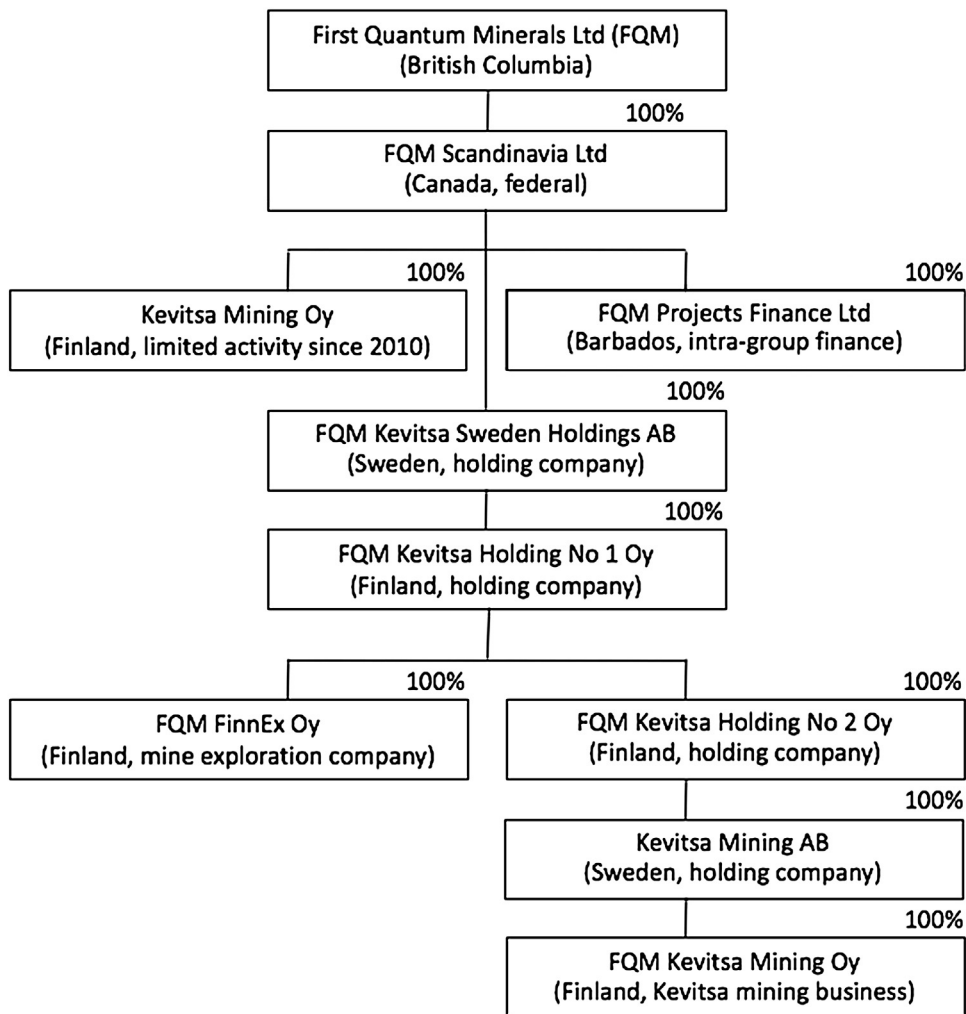
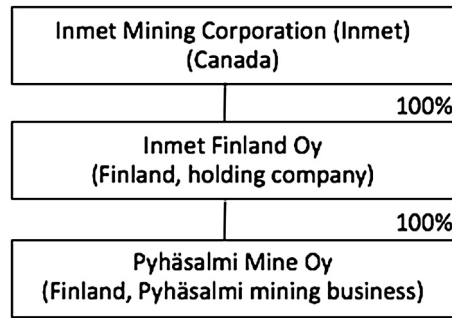


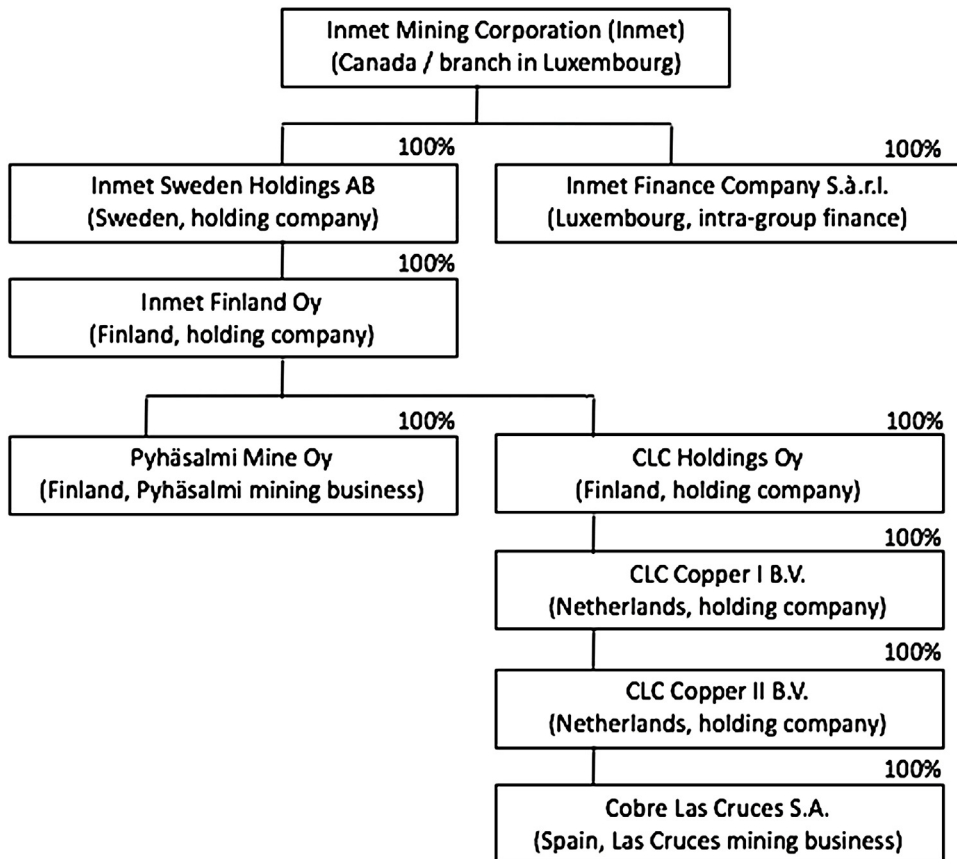
Fig. 2. The corporate structure of FQM Kevitsa mine as of March 31, 2011 (FQM, AIF 2010).<sup>49</sup>

<sup>48</sup> According to the EC proposal, the consolidated taxable profits of a corporate group would be split between countries based on the location of its assets, labor and sales.

<sup>49</sup> FQM had over 50 other subsidiaries related to mines in other countries in 2011. The above structure of Kevitsa was again amended at the end of 2014 when the number of subsidiaries in Sweden and Finland was reduced to three due to mergers (FQM, AIF 2014).



**Fig. 3.** The corporate structure of Inmet Pyhäsalmi mine before the restructurings in 2005 (Inmet Finland Oy, FS 2005; Inmet, AR 2002).



**Fig. 4.** The corporate structure of Inmet Pyhäsalmi mine after the restructurings as of December 31, 2011 (Inmet Sweden Holdings AB, FS 2011; Inmet Luxembourg, FS 2011).<sup>50</sup>

to decide how much taxes corporations pay for the business conducted there. The adoption of a common formula would subordinate much of the power currently enjoyed by MNEs to intergovernmental negotiations whose results would necessarily be some kind of a political compromise. Moreover, it should be noted that all the existing models of international corporate taxation already rely more or less on the use of formulas (Avi-Yonah, 1995; Ylönen & Teivainen, 2015). As John Commons noted in the opening quote of this article, the 'system of prices is like the system of words or the system of numbers', and just like words, 'prices and numbers are nominal and not real'. Therefore, the rules that dictate these prices

<sup>50</sup> The structure remained unchanged for two years after FQM's acquisition (FQM, AIF 2014). Inmet Sweden Holdings AB also held shares in the Çayeli mine in Turkey through a Spanish holding company. Inmet's consolidated accounts did not provide information on the total number of subsidiaries in 2011.

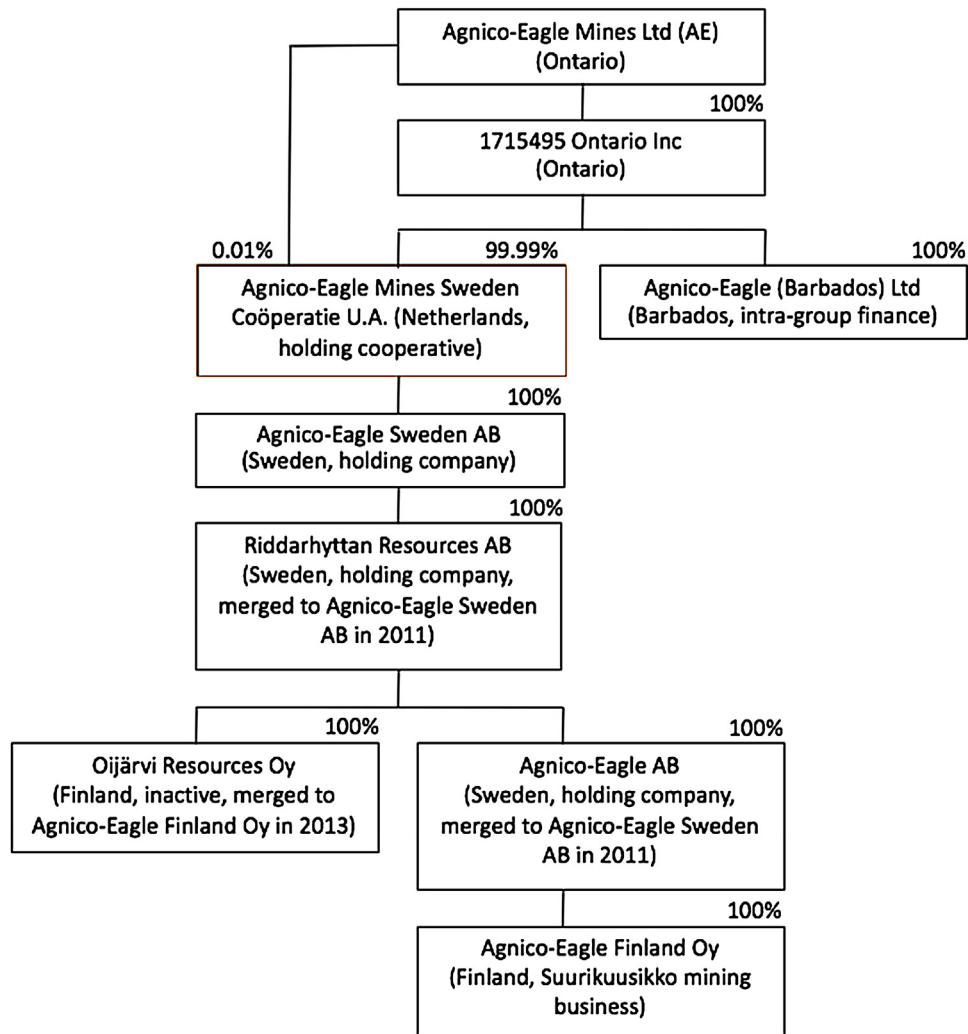


Fig. 5. The AE corporate structure of the Suurikuusikko mine as of March 18, 2011 (AE, Form 20-F 2010).<sup>51</sup>

and their geographical division in corporate wealth chains are of utmost importance to any scholar of accounting, international political economy or tax law.

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<sup>51</sup> Oijärvi Resources Oy was an exploration company half owned by Australian Troy Resources. Later, AE acquired 100% ownership, which enabled it to exploit its tax losses of €4.3 million in 2012, using the Finnish group contribution system, before deregistering the company. AE had 13 other subsidiaries related to mines in other countries in 2011. That number increased to 35 by March 2015. There have been only minor changes in the group structure since 2010 with no major tax implications (AE, FORM 40-F 2014).

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## **Appendix A. List of financial data used in the research**

### ***Kevitsa case study***

First Quantum Minerals Limited (consolidated), Canada  
*Annual information form (CSA)*, 2008, 2009, 2010, 2012, 2013, 2014  
*Annual report (CSA)*, 2008, 2012, 2013, 2014  
 FQM Finnex Oy (2345662-5), Finland  
*Financial statements (PRH)*, 2010, 2011, 2012, 2013, 2014  
*Orbis financial data*, 2010–2014  
 FQM Kevitsa Holding No 1 Oy (2345699-1), Finland  
*Financial statements (PRH)*, 2010, 2011, 2012, 2013, 2014  
*Orbis financial data*, 2010–2014  
 FQM Kevitsa Holding No 2 Oy (2345706-2), Finland  
*Financial statements (PRH)*, 2010, 2011, 2012, 2013, 2014  
*Orbis financial data*, 2010–2014  
 FQM Kevitsa Mining Oy (2345703-8), Finland  
*Financial statements (PRH)*, 2010, 2011, 2012, 2013, 2014  
*Orbis financial data*, 2010–2014  
 FQM Kevitsa Sweden Holdings AB (556814-4041), Sweden  
*Financial statements (EBR)*, 2011, 2013  
*Orbis financial data*, 2010–2014  
 Kevitsa Mining AB (556530-2717), Sweden  
*Financial statements (EBR)*, 2002, 2008, 2010, 2013  
*Orbis financial data*, 2004–2014  
 Kevitsa Mining Oy (2062575-3), Finland  
*Financial statements (PRH)*, 2008, 2009, 2010, 2011, 2012, 2013, 2014

### ***Pyhäsalmi case study***

Inmet Mining Corporation (consolidated), Canada  
*Annual information form (CSA)*, 2010, 2011, 2012  
*Annual report (CSA)*, 2001, 2002, 2011  
*Orbis financial data*, 2003–2012  
 CLC Copper I B.V. (34241191), the Netherlands  
*Financial statements (EBR)*, 2011, 2012  
*Orbis financial data*, 2004–2013  
 CLC Copper II B.V. (34129494), the Netherlands  
*Financial statements (EBR)*, 2011, 2012  
*Orbis financial data*, 2004–2013  
 CLC Holdings Oy (2389092-3), Finland  
*Financial statements (PRH)*, 2011, 2012, 2013, 2014  
 Cobre las Cruces SA (ESA28814135)  
*Orbis financial data*, 2004–2013  
 Inmet Finance Company S.à.r.l. (155174), Luxembourg  
*Financial statements (RCSL)*, 2010, 2011, 2012, 2013  
 Inmet Finland Oy (1635992-3), Finland  
*Financial statements (PRH)*, 2002, 2003, 2005, 2006, 2008, 2009, 2010, 2011, 2012, 2013, 2014  
*Orbis financial data*, 2004–2014  
 Inmet Luxembourg (155271), Luxembourg (branch of Inmet Mining Corporation)  
*Financial statements (RCSL)*, 2010, 2011, 2012, 2013  
 Inmet Mining Sweden AB (556588-3179), Sweden  
*Financial statements (EBR)*, 2002, 2006, 2013  
*Orbis financial data*, 2004–2013  
 Inmet Sweden Holdings AB (556693-7131), Sweden  
*Financial statements (EBR)*, 2006, 2011, 2013  
*Orbis financial data*, 2006–2013  
 Pyhäsalmi Mine Oy (1712341-0), Finland  
*Financial statements (PRH)*, 2001, 2002, 2003, 2008, 2009, 2010, 2011, 2012, 2013, 2014  
*Orbis financial data*, 2004–2014  
 Scandinavian Minerals Limited

*Annual information form (CSA), 2007*

*Annual report (CSA), 2007*

**Suurikuusikko case study**

Agnico-Eagle Mines Limited, Canada

*Annual report (SEC), 2008, 2011, 2012, 2013, 2014*

*Form 20-F (SEC), 2005, 2006, 2009, 2011*

*Form 40-F (SEC), 2014*

Agnico-Eagle AB (556599-9751), Sweden

*Financial statements (EBR), 2005, 2009*

*Orbis financial data, 2004–2011*

Agnico-Eagle Finland Oy (2311020-2), Finland

*Financial statements (PRH), 2010, 2011, 2012, 2013, 2014*

*Orbis financial data, 2010–2014*

Agnico Eagle Mines Sweden Coöperatie U.A. (34361868), the Netherlands

*Financial statements (EBR), 2011, 2012, 2013*

Agnico-Eagle Sweden AB (226690-6185), Sweden

*Financial statements (EBR), 2009, 2010, 2011, 2012, 2013*

Oijärvi Resources Oy (1648603-3), Finland

*Financial statements (PRH), 2009, 2010, 2011, 2012, 2013*

Riddarhyttan Resources AB (556534-7639), Sweden

*Financial statements (EBR), 2006, 2007, 2009*

*Orbis financial data, 2005–2011*

**Other Finnish mines**

Altona Mining Limited, Australia

*Annual report (ASIC), 2014*

Belvedere Mining Oy (2312246-5), Finland

*Financial statements (PRH), 2010, 2011, 2012, 2013*

*Orbis financial data, 2010–2014*

Belvedere Resources B.V. (34161550), the Netherlands

*Financial statements (EBR), 2013*

Belvedere Resources Finland Oy (1044963-7), Finland

*Financial statements (PRH), 2010, 2011, 2012, 2013*

*Orbis financial data, 2010–2013*

Belvedere Resources Limited, Canada

*Annual report (CSA), 2013*

Boliden AB, Sweden

*Annual report (FI), 2014*

Boliden B.V. (3418048775), the Netherlands

*Financial statements (EBR), 2011*

Boliden Harjavalta Oy, Finland

*Orbis financial data, 2005–2014*

Boliden Kokkola Oy, Finland

*Orbis financial data, 2005–2014*

BR Gold Mining Oy (2414435-9), Finland

*Financial statements (PRH), 2011, 2012, 2013*

*Orbis financial data, 2011–2013*

Dragon Mining Limited, Australia

*Annual report (ASIC), 2014*

*Orbis financial data, 2005–2013*

Dragon Mining Oy (1509120-8), Finland

*Financial statements (PRH), 2009, 2010, 2011, 2012, 2013*

*Orbis financial data, 2004–2014*

Dragon Mining (Sweden) AB (556465-5339), Sweden

*Orbis financial data, 2005–2013*

Endomines AB, Sweden

*Annual Report (FI), 2012, 2013*

*Orbis financial data, 2003–2013*

Endomines Oy (1061211-5), Finland

*Financial statements (PRH), 2009, 2010, 2011, 2012, 2013*

*Orbis financial data, 2003–2014*

Hyena Holding AB (556708-2994), Sweden

*Financial statements (EBR), 2011*  
*Orbis financial data, 2007–2013*  
 Kalvinit Oy (1005935-6), Finland  
*Orbis financial data, 2004–2013*  
 Kuhmo Metals Oy (1925450-2), Finland  
*Financial statements (PRH), 2012, 2014*  
*Orbis financial data, 2005–2013*  
 Kuhmo Nickel Limited (05311516), United Kingdom  
*Financial statements (EBR), 2012, 2014*  
*Orbis financial data, 2006–2014*  
 Kylylahti Copper Oy (Boliden Kylylahti Oy), Finland  
*Financial statements (PRH), 2010, 2013, 2014*  
*Orbis financial data, 2005–2014*  
 Lapland Goldminers AB, Sweden  
*Annual Report (FI), 2011*  
*Orbis financial data, 2005–2014*  
 Lappland Goldminers Oy (1907114-0), Finland  
*Orbis financial data, 2005–2013*  
 Nordic Mines AB, Sweden  
*Annual Report (FI), 2013–2014*  
*Orbis financial data, 2009–2013*  
 Nordic Mines Marknad AB (556767-4980), Sweden  
*Financial statements (EBR), 2012*  
*Orbis financial data, 2009–2013*  
 Nordic Mines Oy (2296579-4), Finland  
*Financial statements (PRH), 2012*  
*Orbis financial data, 2010–2014*  
 Outokumpu Chrome Oy (0772768-3), Finland  
*Financial statements (PRH), 2013*  
*Orbis financial data, 2005–2014*  
 Outokumpu Oyj (0215254-2), Finland  
*Annual Report (FIN-FSA), 2014*  
*Orbis financial data, 2005–2013*  
 Talvivaaran Kaivososakeyhtiö Oyj (1847894-2), Finland  
*Annual Report (FIN-FSA), 2013*  
*Orbis financial data, 2006–2014*  
 Talvivaara Sotkamo Oy (1852002-0), Finland  
*Orbis financial data, 2004–2014*  
 Vulcan Exploration B.V. (34639562), the Netherlands  
*Financial statements (EBR), 2012*  
*Orbis financial data, 2010–2014*  
 Vulcan Hautalampi Oy (2300988-4), Finland  
*Orbis financial data, 2010–2014*  
 Vulcan Kotolahti Oy (2300990-5), Finland  
*Orbis financial data, 2010–2014*  
 Vulcan SW Finland (2300986-8), Finland  
*Orbis financial data, 2010–2014*

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# Panama and the WTO: new constitutionalism of trade policy and global tax governance

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## ABSTRACT

Tax havens and tax flight have lately received increasing attention, while interest toward multilateral trade policies has somewhat diminished. We argue that more attention needs to be paid exactly to the interrelations between trade and tax policies. Drawing from two case studies on Panama's trade disputes, we show how World Trade Organization (WTO) rules can be used both to resist attempts to sanction secrecy structures and to promote measures against tax flight. The theory of new constitutionalism can help to explain how trade treaties can 'lock in' tax policies. However, our case studies show that trade policy not only 'locks in' democratic policy-making, but also enables tax havens to use their commercialized sovereignty to resist anti-secrecy measures. What is being 'locked in' are the policy tools, not necessarily the policies. The changing relationship between trade and tax policies can also create new and unexpected tools for tackling tax evasion, underlining the importance of epistemic arbitrage in the context of new constitutionalism. In principle, political actors with sufficient technical and juridical knowledge can shape global tax governance to various directions regardless of their formal position in the world political hierarchies. This should be taken into account when trade treaties are being negotiated or revised.

## KEYWORDS

Trade policy; tax havens; new constitutionalism; Panama; WTO; tax policy.

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## 1. INTRODUCTION: TAXATION AND TAX HAVENS ON THE INTERNATIONAL AGENDA

In this article, we analyze the policy implications of the increasing convergence and overlap of trade policy and tax policy. Specifically, we show how trade policy tools can be used to resist initiatives against tax evasion. This will be done by analyzing two case studies on trade disputes initiated by Panama, in the context of other recent changes in the international tax and trade policies. We argue that, first, there is a need for a more detailed analysis of the trade-tax nexus, and second, that a given position of international capital can be 'locked in' by the active use of trade policy *tools* than enable tax havens to resist tax policy initiatives. Third, this convergence of trade and tax governance not only locks in policies but can also open up new and unintended avenues to challenge the power of global capital. This highlights the importance of epistemic arbitrage of policy professionals. Moreover, it shows that it is a more complex phenomenon than is sometimes thought. We will use the theory of 'new constitutionalism' as a starting point and further show how our findings lead to some implications on the need to reconsider the theory.

Tax havens and tax evasion have indeed become topical fields within global policy. In April 2016, the International Consortium of Investigative Journalists began publishing exposés on 11.5 million leaked documents containing information on more than 214,000 offshore companies founded with the help of a Panamanian law firm and corporate service provider, Mossack Fonseca. In addition to individual investors, the scandal involved a great number of major banks from every part of the world. These banks had received assistance from Mossack Fonseca in opening tax haven accounts for their clients. Several politicians in different countries had to resign. Far from being an isolated event, the Panama papers leak was a continuation in a series of recent tax information leaks from Liechtenstein, Switzerland and Luxembourg. Public debates and pressure (Dallin 2016) have been followed by increased academic attention, which in turn has significantly improved understanding of the mechanisms, actors and structures of tax avoidance and tax evasion.

The nascent literature on global tax governance has focused mostly on tax-specific initiatives, and until very recently, the causes of tax competition have been neglected in the international political economy literature (Rixen 2011, 3). The 1998 OECD *Harmful Tax Competition* initiative has been the most important single event for generating global tax governance research (e.g. Kudrle 2008; Sanders 2002; Sharman 2006; Webb 2004). Since then, several other initiatives have followed, most notably the OECD-led *Base Erosion, Profit Shifting* (BEPS) project that began in 2013 (OECD 2013; see also Eccleston and Smith 2016). Subsequent anti-

tax haven and transparency initiatives launched by the G20 group, European Union (EU) and the United States have also generated interest. These include the Foreign Account Tax Compliance Act by the United States, the OECD-led template for Automatic Information Exchange in tax matters, and several recent EU directives, such as the directive for the exchange of information on national tax agreements negotiated by states with large corporations (Grinberg 2016).<sup>1</sup> Typically, the existing governance research covering this field has provided analyses on policy efforts in the framework of tax-specific work of OECD, EU and the United States. A key question is whether it pays sufficient attention to the major institutional and structural interdependencies: trade policies in particular.

The recent EU state aid cases against tax incentives granted by Ireland and the Netherlands to Apple and Starbucks (EC 2014a, EC 2014b) have drawn some public attention to the overlaps between trade-related goals and tax policies in the field of subsidies. This theme generated attention in the international tax law scholarship around the turn of the millennium (Bratton and McCahery, 2001; Pinto 1998; Schön 1999) but less so within the tax governance literature. In addition, in the early 2000s, the *Harmful Tax Competition* initiative provided inspiration for a body of academic literature discussing international tax regulation also from the viewpoint of the General Agreement on Trade and Tariffs (GATT) and World Trade Organization (WTO) treaties (Avi-Yonah 2001; Brauner 2005; McDaniel 2000; 2004; Slemrod and Avi-Yonah 2001; see also Killian 2006, 1085). These studies found that trade treaties both fostered and hindered policy options for curbing harmful tax exemptions and tax competition.

However, the aforementioned studies did not seem to provoke further research as the general interest toward trade policy issues waned. This neglect of trade-tax policy linkages has also been highlighted in the aftermath of Panama Papers. While there has been at least some policy-level discussion on tax-related aspects in the US–Panama Free Trade Agreement (FTA) of 2007 (Kessier 2016), similar developments have not been seen in the academia. This is unfortunate, as the dynamics between trade policies and tax policies have undergone significant changes since the early 2000s. With the notable exceptions of Farrell (2013) and Bastin (2014), we have not been able to find meaningful analyses from recent years on how trade policy affects anti-tax avoidance initiatives. This is hardly surprising, however, since global tax governance only emerged as a serious research topic in international relations about ten years ago (Dietsch and Rixen 2016, 1). Moreover, the latest research on the interrelations between trade and taxation focuses often on the effects of trade policy on domestic taxes such as the VAT (Seelkopf, Lierse and Schmitt 2016), rather than on tax avoidance.

Here we aim to show how trade treaties and related arbitration procedures can affect the efforts to tackle international tax flight. We begin in [Section 2](#) with a discussion on the expansion of trade policy to include policy fields beyond its historical scope. [Section 3](#) focuses on the rise of international tax avoidance and tax evasion to the global governance agenda, and how the existing academic literature has addressed trade policy related preconditions for tackling tax flight. We then proceed to our case study of Panama in [Section 4](#). The case study discusses the FTA and its potential impact on the international and United States led efforts to tackle tax evasion, and it also analyses Panama's use of trade dispute settlements to protect its secrecy. Finally, the penultimate [Section 5](#) discusses theoretical contributions related to the trade-tax nexus. We conclude by analyzing how these analytical frameworks should be updated, and to what extent can the conclusions from the case studies be generalized.

## 2. THE EXPANSION OF TRADE POLICY AND THE POLITICS OF 'CONSTITUTIONALISM'

The recent history of trade policy has been a history of expansion, reorientation and constant negotiation of the political scope of 'trade' and 'trade-related'. The GATT focused almost entirely on tariff issues for most of its history before the inception of the WTO. Yet already the 1980s saw the development of new areas of negotiation as intellectual property issues emerged to the trade policy field. After the inception of the WTO, new policy issues have been recurrently pushed into the trade policy frame. In several cases, the linkages to traditional trade policies are questionable: procurement, public services, competition, investment protection and so on have no immediate link to tariff policy. Such thematic expansion leads unavoidably to overlap of policy fields, which was very visible already with trade in services, which includes financial services.

This expansion has never occurred without opposition (Deere 2008; Verger and Bonal 2006). Even so, trade policy has evidently become something of a general global policy field. Indeed, with the notorious exception of agriculture, the most heated debates in trade policy during the WTO era have dealt with issues that do not directly involve tariffs on goods. Furthermore, the key political struggles have often been fought over the inclusion of particular issues to the trade policy field rather than the actual content of agreements, with intellectual property rights being a case in point (Borowiak 2004; Sell 2001). The outcomes of the negotiations between trade policy and other policy fields are twofold. First, new extensions of trade policy often means that trade policy overrules existing policies in other policy areas. Second, policy lock-ins generated by trade agreements can affect policy efforts in ways that were



unforeseeable when the agreements were originally negotiated. In some areas, this negotiation with other policy fields has received considerable attention (such as, again, intellectual property), yet other important fields, such as tax policy, have received insufficient attention.

The expansion of trade policy can be seen as an outcome of ad hoc ‘forum shifting’ (Braithwaite and Drahos 2000; Sell 2010): when given political players push for given political goals, they seek arenas in which the existing practices, rules of conduct and power relations are most suitable for advancing the desired policy goals, given that it is in their power to influence the choice of arena.<sup>2</sup> Trade and tax policies are particularly vulnerable for these kinds of practices because of their importance to major corporations and their lobbyists. It is quite well documented, for instance, how the GATT was explicitly chosen as the most suitable arena for pushing the liberalization of trade in services (Raghavan 1990). Similarly, in tax issues, trade policy is likely to be the preferred policy field for tax havens<sup>3</sup>, compared to other international fora.

However, we need to go deeper than this. Here, it is useful to analyze trade policy as an expression of ‘new constitutionalism’ (Raghavan 1990; Schneiderman 2000). The concept was coined for theorizing the globalization of a given market discipline, which restrained the capacity of nation-states to control the powers of international capital. As such power is highly dependent on the laws and other institutions of nation-state, the emphasis of the theory was on the creation of ‘disciplinary neoliberalism’ and its politico-legal dimension, in contrast to the general ‘liberalization’ of finance (Gill 1998a, Gill 2002). This disciplinary neoliberalism shares some key characteristics with constitutions at the national level in entrenching policies, procedures and rights, and in being very difficult to reverse even by majority vote, therefore, the term ‘constitutional’. Future governments are thus inhibited from reconsidering economic policy as it is insulated it from the domain of traditional politics. Trade agreements can be interpreted from this perspective as transnational quasi-constitutions, protecting the interests of corporate capital and transnational investors by creating global uniform and binding rules for this purpose (Clarkson 2002). As the field of trade policy has expanded, trade agreements have taken ever more pronouncedly such quasi-constitutional role in the global economy.

The domestic forms of such ‘new constitutionalism’ can take different forms. The *regulatory chill effect* creates pressure on the domestic policy-makers to consider only measures that are known to conform with the ‘constitutional’ agreements, while the *lock-in effect* effectively binds governments to the current level of liberalization (Krajewski 2011). Thus the former self-disciplines politicians and regulators, while the latter leads into actual sanctions by supranational political bodies. Domestically important policies can be sanctioned and outlawed by dispute settlement



bodies (DSBs), when a trading party actively seeks to undermine these domestic policies. This can lead to a regulatory chill, as policy-makers become wary of using politically efficient means for achieving given policy goals.

Researchers have pointed out examples of ‘policy lock-in’ in virtually all kinds of trade negotiations, with possibly the most evident case being negotiation on trade in services such as GATS (Robertson 2003, Sreenivasan 2005). Russell Williams sees the very essence of ‘new constitutionalism’ to be an attempt to ‘strike when the iron is hot’: while support for given practices might decline over time, deliberate policy lock-in hinders the attempts to push through changes at a later point domestically (Williams 2002, 80). While some policy issues might remain open after signing the agreements, they quickly take the form of judicial matters instead of traditional political disputes. There are also examples of attempts to push for comprehensive deals that do not allow withdrawal. As one researcher observed on the GATS negotiations: ‘teams from OECD nations deliberately tried to “bamboozle” opposing countries [...] The attitude of the developed countries negotiation teams was “sign now, define later”’ (Raghavan 1990, 108).

Yet curiously, this theorizing almost invariably associates democratic politics with national sovereignty, as popular sovereignty is taken as a manifestation of democratic powers (Schneiderman 2000). Nonetheless the opposite can be the main concern in taxation issues. In discussions on tax havens, for instance, a commonly noted problem has been the capacity of small states to commercialize their sovereignty (Palan 2002) by using their national sovereignty to create legal ‘innovations’ demanded by the tax avoidance industry. Therefore, in contrast to much of the new constitutionalism literature, progressive tax policy does not necessarily equal protecting national jurisdictions from transnational policy lock-ins. This is true especially in an era when the Big 4 auditing companies are helping secrecy jurisdictions to design their tax laws and large corporations can easily discern their internal wealth chains from value chains (Christensen and Murphy 2004; Otusanya 2011; Seabrooke and Wigan 2014; Seabrooke and Wigan *in press*; Sikka *in press*; Sikka and Hampton 2005, Sikka and Willmott 2010). Rather, progressive trade policy should be seen as a tool used by sovereign nations to push other sovereigns to adhere with effective tax information exchange and other similar initiatives.

In other words, the new constitutionalism of trade policy can set the limits within which both popular sovereignty and commercialized sovereignty can operate. The question is, then, how can trade policy be effectively used in taxation issues. The political core of trade policy in such cases does not appear to be introducing (binding) *rules* but rather effective *tools*, which can be used at will to affect global policies on other

policy fields. What is more, the ability to use these tools requires sophisticated expertise from fields that have so far been marginalized in international tax discussions, which highlights the role of epistemic arbitrage in policy making. This issue is further complicated by the fact that global trade policy consists of several overlapping, yet imperative, trade policy systems.

Next, we will move on to discuss the overlap and the convergence of trade and tax policies based on this theoretical background. The discussion on the history of policy convergence and recent case studies will demonstrate how the dominant economic forces are ‘insulated from democratic rule and popular accountability’ (Gill 1998b, 23), yet in a manner which calls for some reconsideration of the form of lock-in as it is typically described by the new constitutionalist theory.

### 3. TRADE AND TAXES: A MIXED HISTORY OF POLICY CONVERGENCE

Tax issues have become more prominent in the trade agenda with the emergence of trade in services. As services naturally include financial services, and tax avoidance increasingly happens through intangible rights, trade agreements might facilitate illicit financial activities. Defining investment broadly in the agreements to include complex financial instruments, mere expectations of gain, and so on further exacerbates the problem. Moreover, the concept of state aid has recently expanded at least in the EU, encompassing not only direct subsidies to local companies but also different forms of ‘tax competition’ or tax wars. These changes force to reconsider the complementarity of the two regimes.

The first interventions of trade policy into tax issues broadened the definition of tax-related export subsidies to include ‘the full or partial exemption, remission or deferral [of tax] specifically related to exports’ in the 1979 GATT Subsidies/Countervailing Measures Agreement (McDaniel 2000, 1628). The pre-1985 version of GATT does not appear to have been invoked frequently in tax-related disputes. The notable exception is the challenge by the European Community and Canada to the US Domestic International Sales Corporation (DISC) regime. A panel of experts established by the GATT Council deemed ‘that DISC conferred a tax benefit related to exports’. The Treasury aggressively promoted the use of DISCs by US corporations and issued annual reports showing that exports had increased as a result of the DISC regime. This evidence made it rather easy for the panel to conclude that DISC constituted an ‘export subsidy’ (McDaniel 2000, 1627). The same panel concluded that the French exemption of income from export sales likewise was a subsidy under GATT. The key to this seemingly surprising result was that France, Belgium, and the Netherlands were applying their exemption systems to

transactions that originated in their respective countries, not just to transactions that took place wholly outside their countries (McDaniel 2000, 1628).

The realization of tax holidays as potentially trade-distorting acts was the first clear instance of the conflict between these two policy domains. The prominence of the trade-in-services negotiations in the Uruguay Round, and the growing presence of foreign direct investment, highlighted how taxation of factor incomes can constitute a fiscal barrier to trade (Slemrod and Avi-Yonah 2001, 533). The GATT Subsidies Code defines 'subsidy' as including cases where government revenue that is otherwise due is foregone or not collected. To be actionable under the GATT, a subsidy must be 'specific to an enterprise or an industry or group of enterprise or industries' (Avi-Yonah 2001, 1684-1685).

Subsequently, new rounds of GATT created the WTO and expanded significantly its scope in tax affairs. The first step under the WTO processes is to establish that a challenged provision is a subsidy. A 'prohibited subsidy' is contingent on export performance or requires the use of domestic rather than imported goods, i.e. an export subsidy. In turn, the term export subsidy includes 'full or partial exemption, remission or deferral, specifically related to exports, of direct taxes', and the allowance of 'special deductions' directly related to exports or export performance (Avi-Yonah 2001, 1630).

The EC has moved quite aggressively to challenge special tax provisions that it believes conflict with Article 92(1) and its own tests interpreting that article. In 1998, it adopted a formal set of guidelines which, if violated, would prohibit all preferential tax provisions that adversely affect trade and competition among EU states (Avi-Yonah 2001, 1634). These guidelines coincided with the aforementioned OECD's *Harmful Tax Practices* initiative but have not received equal attention in the global governance research, even though it marked the beginning of a significant shift in the definition of state aid in the EU. Originally restrained to direct subsidies, the soft law approach adopted by the EC and supported by the 1998 Code of Conduct of Business Practices has gradually expanded to tax issues. One milestone in this development were the 2014 landmark decisions that prohibited the tax incentives that Ireland and the Netherlands had granted to Apple and Starbucks as market-distorting state aid (EC 2014a; 2014b).

Transfer pricing and the taxation of TNCs pose the biggest challenge to current trade regimes, as identifying and measuring 'market-based' prices for exports, imports, and even for intra-firm financing is extremely difficult. There are several potential problems. First, it is sometimes difficult to determine whose income is identified and measured. The definitions of resident and nonresident taxpayers differ. Second, the arm's length principle championed by OECD and bilateral tax treaties that are

usually based on it provide rules for dividing incomes within companies, but their application is far from straightforward (Clausing 2003; Durst and Culbertson 2003; Eden 2016; Picciotto 1992; 2016), and the new initiatives by OECD and individual countries have fallen short from abolishing artificial profit shifting. As a result, corporations get large freedoms to decide where they want to show profit (Ylönen and Teivainen 2015). Considering all this, EC's decision to consider transfer-pricing related tax incentives as *de facto* subsidies was in many ways understandable (Braumer 2005, 279).

Typically, trade agreements permit a wide range of exceptions, but these exceptions need to be explicitly specified in the contract. Thus problems arise when required policies have not been foreseen in the trade negotiations. There are examples of trade agreements where one party of the agreement has knowingly under-regulated some aspect of its economy, and the other party has later unsuccessfully challenged this under-regulation in WTO.<sup>4</sup> Therefore, one could expect that a country with intentionally under-regulated financial services could find interventions against these practices as a violation of the trade agreement. Furthermore, the use of investor-state dispute settlements has grown in place of conventional inter-state disputes. This increases the likelihood that financial actors use arbitration panels to protect themselves against anti-tax avoidance policies.

To further complicate the issue, Bastin (2014) has suggested that WTO rules could also be used to advocate for more stringent control of transfer-pricing rules. In key role here is the Committee on Customs Valuations (CCV) of the WTO and its sister committee in the World Customs Organization, namely the Technical Committee on Customs Valuations (TCCV). Both committees are engaged in transfer pricing related work. According to Bastin, the most important outcome from the CCV's and TCCV's work on transfer pricing to date is the TCCV's Commentary 23. This Commentary points to the Article 1(2)(a) of the WTO's Customs Valuation Agreement<sup>5</sup>, which states that the 'circumstances surrounding the sale' should be used to assist the determination of whether the relationship between the parties influenced the price (Bastin 2014, 69). This article could potentially be used to tackle aggressive corporate tax avoidance. Moreover, Bastin (2014, 76) highlights the Article XXIII(1)(b) of GATT. It dictates that

- (1) if any contracting party should consider that any benefit accruing to it directly or indirectly under this Agreement is being nullified or impaired or that the attainment of any objective of the Agreement is being impeded as the result of (...)
- (b) the application by another contracting party of any measure, whether or not it conflicts with the provisions of this Agreement (...)

the contracting party may, with a view to the satisfactory adjustment of the matter, make written representations or proposals to the other contracting party or parties which it considers to be concerned. Any contracting party thus approached shall give sympathetic consideration to the representations or proposals made to it.

In principle, this article could also be used to challenge tax-driven transfer-pricing decisions. However, effective application of these articles and commentaries would require both sufficient knowledge on international trade *and* tax law, and the political will and vision to employ this knowledge. The concept of epistemic arbitrage by Seabrooke (2014, 50) can be useful in understanding this dynamic. Epistemic arbitrage refers to the ways in which ‘particular professionals are able to exploit differences in professional knowledge pools for strategic advantage by positioning particular forms of knowledge as the most appropriate to deal with particular problems’. When successful, ‘those engaging in epistemic arbitrage—the arbitrageurs—can become epistemic “arbiters” who decide how to address transnational problems and who can address them’ (Seabrooke 2014, 50). While the significance of expertise has been noted for example in reference to the capacity of civil society organizations to influence trade policy (Trommer 2014), increasing convergence of trade and tax policies creates a demand for new kinds of experts or teams of experts that can operate simultaneously in both domains. Thus the successful utilization of the lock-in of policy tools depends increasingly on how well states or interest groups are able to tap in to these epistemic communities. Related to this, the next section will discuss how Panama was able to invoke WTO rules to defend its tax regime.

#### 4. THE CASE OF PANAMA

As noted in the beginning of this article, Panama has been active in linking tax issues to the broader trade agenda. Of particular interest are the two WTO arbitration cases that Panama has initiated in recent years. The first case dealt with anti-money laundering efforts by Colombia, and the second one tried to overhaul Argentinian attempts to enforce an international ‘black list’ of tax havens. Both cases can be deemed as wins for Panama, although the results of the latter case were mixed. A point of further interest is how these cases have influenced trade policy related discussions in the United States amidst the negotiations for the US–Panama FTA and the Tax Information Exchange Agreement (TIEA) that was negotiated around the same time.

A country with a population of less than four million people, Panama is home to more than 350,000 secretive International Business Companies, second only to Hong Kong and the British Virgin Islands. Panama

has been an active promoter for secretive and tax-evading trusts and foundations, as well as being a major player in insurance, boat and shipping registration (Financial Secrecy Index 2015). This offshore interface (Christensen 2011) and the accompanying ancillary legal and tax services have made Panama a prominent destination for tax-driven financial flows. It occupies the 15th place in the 2015 Financial Secrecy Index, which compares jurisdictions based both on the infrastructure they offer for concealing investments, as well as their importance in the world economy.<sup>6</sup>

The history of Panamanian financial services dates back to 1903, when the United States supported a revolution in the area that had been a province of Colombia. A year after this W. H. Taft, who was the US Secretary of War and commissioner of the projected canal, drafted a legislation that formed the basis of the Panamanian financial system. In the same year, the predecessor of Citibank started business in Panama (Naylor 2004, 186). The Panamanian Flag of Convenience registry began operation in 1919, when Panama helped Standard Oil to avoid US taxes by starting to register foreign vessels. Financial flows followed, as Wall Street interests pushed Panama to introduce secrecy-oriented business incorporation laws in 1927 (Robinson 2003; Shaxson 2011) and trust legislation in 1941 (Aguilar-Alfu 2012). As late as in the 1960s, Panama was one of the only 11 financial centers listed by the US Federal Reserve (quoted in Naylor 2004, xi), highlighting its pioneering role. This can be contrasted with some 70 centers the IMF listed in the late 1990s (Errico and Musalem 1999).

The OECD's *Harmful Tax Practices* initiative began in 1998. Panama did not commit to reforms based on the OECD's blacklist of non-compliant jurisdictions (Sharman 2006, 15). What is more, it was also one of the 14 jurisdictions that formed the International Tax and Investment Organization ITIO in March 2001 to counter OECD anti-tax-avoidance efforts (Sharman 2006, 59).<sup>7</sup> In the post-financial crisis environment, Panama also reacted aggressively to the OECD-led blacklisting effort, for example by denying Spanish companies access from bidding on the lucrative contracts in the expansion of the Panama Canal (Panama Investor 2008).

At the time of writing, Panama has 14 double tax agreements (DTAs) and nine TIEAs in force and more pending (International Bar Association 2016). The DTA partner countries involve major economies such as the Czech Republic, France, Israel, Mexico, Portugal, Spain and the United Kingdom, but also Barbados, Luxembourg and the United Arab Emirates. With the exception of Canada and the United States, Panama has signed all of its TIEAs with a group of Nordic countries that negotiated these agreements jointly after the 2007–2009 financial crisis, offering many tax havens a convenient way to escape the second coming of the OECD's blacklists.<sup>8</sup> Moreover, both the Canadian and the US TIEA

contained a clause that allowed Panama to deny an information request 'where the disclosure of the information requested would be contrary to the public policy of the requested Party'.<sup>9</sup> Finally, Panama has also been one of the few tax havens to effectively opt out from the OECD's ongoing effort to expand automatic exchange of tax information, even though the OECD model still retains several loopholes and thus leaves room for continuing a secrecy-based development strategy (see, e.g. Bachus 2015; Cardiel 2016; Rose 2016).

Panama's refusal to engage in effective international tax cooperation has been accompanied with its use of trade policies to restrict attempts by other countries to curtail tax flight and financial crime. Panama has been a member of the WTO since 1997. During that time, it has been complainant in seven disputes, a respondent in one dispute and a third party in eight cases. Since October 2012, Panama also has a new trade agreement in force with the United States, replacing US unilateral preferential trade treatment under the Caribbean Basin Economic Recovery Act, the Caribbean Basin Trade Partnership Act and the Generalized System of Preferences (GSP) (Hornbeck, 2012). Panama has typically signed cooperation agreements only under pressure and even then, compliance has often remained half-hearted.

We focus on two particular cases in which Panama was the complainant, out of the total of five issues that Panama has brought to the WTO (one issue consisting of three similar cases related to banana trade with the EU). Case 453 is related directly to anti-tax avoidance initiatives applied by Argentina. Case 366 dealt with Colombian efforts to enforce anti-money laundering measures. We will present these two cases in Subsections 4.1 and 4.2. The cases are similar to each other in their political significance: using trade agreements to avoid being subject to effective policies against tax flight. Yet they utilize different domains of trade agreements: trade in goods covered by the GATT in 1994 in the case of Colombia, and trade in financial services covered by the GATS in the case of Argentina.

#### **4.1. The case against Argentina's anti-tax haven efforts**

The case against Argentina started in December 2012, when Panama brought a complaint to the WTO regarding a range of tax, investment, and services measures that Argentina had imposed against a number of countries, which it classified 'non-cooperative'. The non-cooperative country status was assigned to countries that refused to sign an agreement with Argentina on the exchange of tax information, or initiate the necessary negotiations (Panel report<sup>10</sup> 7.182, referring to Argentine legal code 589/2013). The measures included 'less favorable tax treatment in the collection of profits taxes, discriminatory tax treatment on funds



entering from the listed countries, discrimination in the valuation of transactions with persons from the listed countries, and discriminatory criteria with respect to tax deductions' (Zagaris 2015, 40), as well as the criteria for entering the Argentine reinsurance market. The contested legislation consisted of eight separate measures (Panel report 2.13, 2.17, 2.19-2.20, 2.21-2.22, 2.26-2.27, 2.35, 2.37, 2.39-2.40).

Panama argued that these measures illegally discriminated against foreign service providers. According to the challenge, Argentina restricted market access for reinsurance and retrocession services from the listed countries and imposed authorization requirements 'for the purchase of foreign exchange and the repatriation of direct investments by entities in the listed countries'. Panama considered these measures a violation of Argentina's WTO commitments as well as the organization's core principles (Zagaris 2015, 40). Specifically, Panama challenged the consistency of the measures with Article II:1 of the GATS.

In a significant passage, Argentina informed that it had now removed any references to 'countries with low or no taxation', including Panama, from the decrees (Zagaris 2015, 40). This effectively aligned Argentina's decrees with the fiscal transparency coordination criteria of the OECD. Despite the loopholes in the OECD's information exchange models, Panama was not convinced. It deemed the changes 'superficial' and 'cosmetic'. In way of a response, WTO's DSB decided to establish a panel to settle the dispute on 25 June 2013. The panel report was circulated in September later that year, and the final appellate body report was published in 14 April 2016.

In its response to the DSB, Argentina argued that the measures were 'defensive tax measures', and were in line with the recommendations of the Global Forum on Transparency and Exchange of Information for Tax Purposes (Panel report 7.527), as well as with G20 guidelines. According to Argentina, the measures were designed to prevent tax evasion, tax avoidance and fraud (Panel report 7.527, 7.534). Argentina further argued that Article XIV(c) of the GATS allows actions to prevent deceptive and fraudulent practices, and as its measures aimed at countering harmful tax practices, they were arguably consistent with the GATS (Panel report 7.534-7.535). Furthermore, Argentina argued that paragraph 2(a) of GATS Annex on Financial Services justified some of the measures, as it allows protecting 'financial consumers from distortions and abusive situations'.

In its complaint, Panama argued that GATS aimed solely at securing non-discrimination between producers of (financial) services, suggesting that Panama saw trade policy, and particularly GATS, as tools to continue resisting international tax cooperation. It argued this position clearly in a submission to the appellate body after the panel decision, which itself was positive for Panama. Panama appeared to understand



the rationale behind the imposed measures, but argued that they went beyond the means necessary to secure compliance with laws and regulations on fraudulent transactions (Panama's appellants' submission 5.100, referred to in Appellate body's report 6.214). Panama maintained that the policy statements derived from the OECD and G-20 reports were general, abstract, and non-country-specific (Panama's appellant's submission 4.37, appellate body's report 6.149). Furthermore, Panama emphasized non-discrimination and equally favorable treatment, and saw any political sensibilities as a secondary concern. (Appellate body's report 6.62).

Noteworthy, the panel accepted Argentina's argument that transactions with entities of non-cooperative countries enable tax evasion because of the secrecy laws in these countries (Panel report 7.655). The Panel argued that most of the contested measures contributed to the safeguarding Argentina's tax collection system and to the prevention of money laundering (Panel report 7.713, 7.717). It also found support for Argentina's claim on the importance of accessing tax information in several documents by the G20, OECD and the Global Forum (Panel report 7.509-7.513). It even considered the measures to have very little restrictive impact on international trade, with the exception of one specific measure (Panel report 7.727). The panel found that Panama was unable to identify any 'alternative measures reasonably available for Argentina less trade-restrictive but with the same objectives' (Bridges weekly, 21).

The panel did however dismiss Argentina's claim that general GATS exceptions allow using measures that violate GATS obligations. As argued by Panama, paragraph 2(a) should be invoked only when the measure in question qualifies as 'domestic regulation', such as a 'supplier's technical standard, qualification or license' (Panel report 7.828). Practically, the decision delineated the legitimate policy space available in implementing measures against tax evasion, and the extent to which GATS exceptions can be invoked. The legal reason given for the effective lock-in promoted by the panel was mostly based on the concept of 'likeness' (Panel report 7.185-7.186). GATS stipulates that similar treatment should be accorded to 'like' services from *any* origin. Interestingly, the requirements for 'like' treatment include also service suppliers. In addition to like treatment of 'service suppliers' of different origins, a 'service supplier' is defined in extremely broad terms (GATS XXVIII b, g). Thus, the panel reasoned that Argentina treated services *and service suppliers* from non-cooperative countries differently than those from cooperative countries (Panel report 3.1.a-h). In the same vein, some of Argentina's measures were seen to accord less favorable treatment to Panamanian services than like domestic services (Panel report 3.1 b-d).

The panel also noted that Argentina used origin as a basis for distinguishing service suppliers on which it imposed the contested measures. The key point appeared to be, whether Argentina's measures are

accorded *exclusively* on the basis of origin. Superficially, of course, the distinction used in Argentina's measures was based exclusively on origin, since the problems arose directly from the tax haven regime of Panama. Eventually, 'like services' were defined as 'services which are in a competitive relationship' (Panel report 7.159), and the burden of proof to show that tax avoidance affects the competitive relationship of service providers was put on Argentina (Panel report 7.179). The panel eventually found the evidence provided by Argentina insufficient.

The case highlights the diminishing policy space for effective work against tax evasion when a tax-haven country manages to use epistemic arbitrage through WTO. The recognition of Argentina's purposes and the lack of alternative means did not allow using the exceptions stipulated in GATS. The Panel explicitly stated that all measures imposed by Argentina fall under the scope of GATS. Therefore, anti-tax evasion policies can become trade policy issues also in the future. While some of Panama's claims were rejected, all eight measures were seen as inconsistent with GATS II:1 (Panel report 8.2.a), as they do not accord similar treatment to like services from co-operative countries (Panel report 8.2.b). The appellate body further reversed some of the Panel's findings, but this does not remove the fact that all WTO organs considered the case to fall within the scope of GATS. This turns trade agreements into policy tools for tax havens, and potentially also for countries aiming to oppose them.

#### 4.2. The case against Colombia's anti-tax haven efforts

Another case in which Panama used trade treaties to challenge anti-money laundering efforts was the case of Colombia in 2009. This case once again demonstrates how a country can be forced to prioritize trade agreement commitments over anti-money laundering policies, even when their impact on trade is questionable.

Colombia is a prime example of a country suffering from the effects of money laundering facilitated in great extent by Panama (Panel report 4.142<sup>11</sup>). According to estimates, over 80 per cent of Colombia's trade with Panama is contraband trade. Problems are further exacerbated by the lack of control in Panama's free trade zone Colon. It has been identified as a focal point for illicit trade (Panel report 4.60) and as a key point for the laundering of Colombian narco-trafficking money. Panama's reported exports were threefold in comparison to Colombian imports from Panama, which indicates under-invoicing and smuggling. Thus Colombia was faced with an important domestic problem, which it needed to address (Panel report 4.81).

The uncooperativeness of Panamanian authorities emptied Colombian attempts to find common solutions (Panel report 4.85). The response rate

to Colombian assistance requests in customs co-operation was 0.65 per cent in 2001–2005 (Panel report 4.173). Therefore, Colombia decided to introduce new measures, requiring certain Panamanian imports such as footwear and textiles to enter through designated ports of entry (the airport of Bogota and the seaport of Barranquilla). These ports were modern, well-staffed and close to relevant markets, and had dedicated personnel for contraband concerns (Panel report 4.5; 7.217). In addition, Colombia established ‘indicative prices’ for certain products for dealing with price distortions (Panel report 2.11). The policies were a rational response to a well-established problem: they represented an effective use of scarce means to counter a specific problem, and their trade-distortive effect was designed to be minimal, or non-existent, (Panel report 4.171).<sup>12</sup>

Panama challenged these policies, claiming that the indicative prices system discriminated internal tax in excess to taxes on like domestic products, making it inconsistent with Article III:2 of the GATT 1994 (Panel report 4.18), as well as with parts of the Customs Valuation Agreements (Panel report 4.44). Furthermore, Panama argued that restraining the ports of entry imposed quantitative restrictions that were applied in a discriminatory way (Panel report 4.33, 4.40), violating the Article XIII:1 of the GATT 1994 (Panel report 4.32). In its response, Colombia maintained its position that customs duties based on indicative prices should be seen as a deposit rather than a payment (Panel report 4.100), and that Colombia has the right to use these indicative prices in examining whether declared values of goods are truthful or accurate (Panel report 4.105). Moreover, Colombia claimed that Panama had failed to provide any evidence proving that the referenced measures did indeed restrict trade (Panel report 4.63).

In its decision, the Panel (WT/DS/366/9) found the indicative prices measure inconsistent with the Agreement on customs valuation of the GATT (Panel report 8.1, 8.2) and the ports of entry requirement inconsistent with Article I.1, V:2, V:6 and XI:1 of the GATT 1994. The panel rejected Colombia’s defense that the ports of entry measure was justified under Article XX(d) of the GATT 1994 for securing compliance with Colombia’s customs legislation (Panel report 8.7), and saw the indicative prices as discriminatory payments rather than deposits (Panel report 7.87). The panel recognized that the measures were designed to secure compliance with Colombian legislation and noted the importance of combating under-invoicing and money laundering (Panel report 7.543, 7.566). Yet it found that Colombia had not proved that the ports of entry measure contributed to these goals (Panel report 7.585, 7.588, 7.618). The panel referred merely to the ‘undoubtedly’ increased transaction costs for Panama. Colombia appears to have been penalized for simultaneously using several tools in its anti-money laundering efforts, as it had

to assume the burden of proof. It would have been far easier to demonstrate the marginal contribution of a single policy tool.

As a result, Colombia was forced to revise its policies. Furthermore, it was expected to make the revisions within months, and thus to prioritize fast compliance with the ruling over normal political and legislative procedures. Colombia requested a 15-month implementation period so that it could explore legislative alternatives and their WTO-consistency for complying with the Panel decision while continuing its anti-tax evasion efforts (Arbitrator's report, 13–15). Colombia suggested the increased number of ports of entry required new legislation in order to continue its anti-smuggling efforts. Once again, Panama managed to use the WTO framework to force fast compliance at the expense of political sensibilities (Arbitrator's report, 111), even though some previous arbitrators had noted that new legislations were based on the need to safeguard public morals and order (Arbitrator's report, 29). Panama saw the need to address the underlying problems of customs fraud and contraband irrelevant in determining the pace of compliance. Panama thus saw the implementation as separate from the removal of 'underlying economic or social conditions' (Panama's submission, para 6, referred to in Arbitrator's report, 37).

Panama argued that there was no 'unfettered right to any method of implementation', and that it only accepted the withdrawal of the indicative prices and ports of entry measures (41). The claim was based on the idea that any means to replace the 'payment' system in indicative prices with a compulsory 'guarantee' system, and restraining the ports of entry, would violate the same GATT articles (Agreement on customs valuation and Article XI). Clearly, Panama aimed to ensure that the WTO process would block any attempts to replace the measures with similar ones.

Several issues stand out in the challenge and in the decisions of the Panel and the arbitrator. First, there was no existing precedent of such a case. Second, the status of being a developing country did not deter Panama from entering the process. Third, Panama launched the case on behalf of its offshore, not onshore, firms. What is more, the panel did not require Panama to demonstrate that anti-money laundering rules had a negative impact on trade. All these issues ought to have led to further concern, that Panama (or other tax havens with similar characteristics) could use FTAs to block progressive taxation policy by branding them as inconsistent with trade treaties. For example the US-Panama FTA has raised concerns that it provides Panama measures for similar legal struggles against progressive tax legislation. While this concern has mostly been voiced by the civil society (Tucker 2011), even the US administration was hesitant to enter the FTA before signing a TIEA with Panama (Hornbeck 2012, 2–3).

## 5. RETHINKING THE TRADE-TAX NEXUS

Trade, investment, and tax policies have traditionally been seen as complementary (Slemrod and Avi-Yonah 2001, 533), and the supranational dimension of the WTO or other trade treaties has not been thought to affect the operation of the international tax regime. When tax and trade policies have been discussed together, they have usually been compared to each other instead of analyzing the ways in which these two spheres overlap (Rixen 2008, 178). While this arrangement did not cause any serious problems for long periods of time, the conflict between the international trade and tax regimes has now become more pronounced (Bastin 2014; Brauner 2005, 256; EC 2014a; 2014b).

What is changing, to begin with, is the comprehensiveness and regulative form of the policy domains. The WTO aims to harmonize domestic legislation, operating in a virtual international economic space as an interface between the various legal systems. In general, WTO does not directly modify or relate to any specific domestic regulation, but rather dictates standards with which member countries align their laws. Trade treaties are based on pooling together sovereignty for a common cause, which can either restrict or support international cooperation against tax avoidance and evasion. In this sense, the pooling process differs markedly from the pooling of sovereignty witnessed in the field of tax policy, which is more typically geared to combating international tax wars (Christensen and Shaxson 2016) between states than it is to accelerating them (Genschel and Rixen 2015).

The trade policy regime, which was for a long time moving towards more coherence, has reached something of an impasse. It is now evolving again through a myriad of regional and bilateral treaties, and thus functions as a platform for sporadic harmonization. In the case of tax policy, on the other hand, there have been frequent attempts to form ever more comprehensive policies, in part because there is a strong push for multilateral solutions, manifested already in the development of multilateral tax information exchange. This shifting dynamic also both intensifies negotiations between the two policy domains, and creates more opportunities for policies and business practices that seek to benefit from the overlaps. In earlier decades, the fragmented international tax regime could operate relatively independently from the coordinated trade regime. Now, the increasingly patched trade policy regime can, in surprising ways, affect efforts to build a more coordinated tax policy regime, instead of being the policy domain dictating global uniformity in policies.

The increasing overlaps between trade and tax agendas create also challenges for the prevailing theories in IR and global political economy that have been used to explain these kinds of phenomena. In particular, this calls for reassessment of the traditional theories of new

constitutionalism. This theory has correctly pointed out that policies advocated in trade deals to be very resistant to political change, and that the ‘power of transnational capital depends on the form and character of state institutions’ (Gill 2008, 116). However, our case studies show that this lock-in should in some cases be seen rather as a tool for given governments to push their agenda, instead of as a strict and pre-negotiated limitation on the existing policy space, or even a ‘regulatory chill’. While lock-in effect might be very real in the sense of effective insulation from democratic politics, the case studies demonstrate that the ways that policies are locked in can be unanticipated when the treaties are signed. The new constitutional theory generally does a good job in picturing the balance of power between capital and the political realm, but it typically assumes that global uniform treaties limit the policy space especially of smaller national states (Gill 2008, 138–142). Yet it appears that the power of capital might enable even miniscule nations means to affect or direct the power of mobile international capital. The ‘constitutional’ power in trade policy needs to be understood not as a straightforward lock-in, but rather locking in policy tools, which can be utilized by experts to different ends.

Even though these notions might appear as purely theoretical in the cases discussed at length above, in other instances a similar trade-tax convergence can create tools for pushing for more progressive agendas. As an example, we pointed out that the existing trade treaties could create grounds for challenging aggressive transfer pricing regimes and policies. Moreover, we highlighted how the state aid regulation in the EU has developed rather sporadically to a point where tax concessions granted for companies like Starbucks and Apple are commonly seen as illegal subsidies, even though the majority of the revenues to these Irish and Luxembourgian subsidiaries come from other countries.

These notions point to the significance of the role of arbitration specialists not only in traditional trade issues (Schneiderman 2000), but also as gatekeepers in trade disputes whose outcomes can either promote or hinder policies against tax avoidance, tax evasion and tax havens. Looking at the myriad of different ways trade policies have influenced or can influence tax policies through WTO, EU and other channels, it would be a grave oversimplification to say that these developments would have outright separated ‘the “economic” from the “political” and “locked in” already-adopted free market policies through use of legal guarantees and sanctions to favour private determination of economic policy’ (Gill 1998b, 25). Rather, the intertwining of tax and trade policies gives more power to the agents that understand the connections between these policy spheres and can either exploit them or recruit the necessary expertise for doing that. These agents can either be states or advocacy groups that are able to make states to adopt their agenda. Thus while the outcome of

the processes described above can indeed be in line with what is called neoliberal, the politics are not outright 'disciplinary' (Gill 2008, 137–138), but rather open a space for the experts to maneuver. In such a contested space, the existing policy tools can well be locked-in in a very constitutional manner, but the political outcomes are not completely closed or predetermined. This can be highlighted also by the evolution of the EU state aid regime: in absence of clear policy coordination from the European Council, the civil servants in the European Commission have gradually expanded the state aid regime to include also tax avoidance issues.

Even though Panama has a population of less than 4 million people, it has had the required expertise and the will to come up with ways to harness WTO rules for promotion of its political goals. This expertise appears to be significant in the cases described above, implying that geopolitical hegemony (Cox 1983) is not sufficient in analyzing political possibilities and limitations to maneuver in the context of global policy. Rather, the cases are an example of epistemic arbitrage (Seabrooke 2014) where the holders of particular kind of specialized information become gatekeepers in policy-making. However, the examples highlighted earlier by Bastin demonstrate that some other small or big state could do the same by employing different GATS articles for curbing international tax avoidance and evasion. What is more, the EC has also resorted to plenty of improvisation in its gradual shift that has resulted in seeing some aggressive corporate tax practices as state aid. In this case, the shift has been a result of unwillingness of the European Council to provide political guidance, which has increased the role of soft law and improvisation in EC's alignments.

As we noted briefly in the Section 2, this fragmentation can also greatly affect the commercialization of sovereignty (Palan 2002). Whereas existing research has highlighted the importance of tax legislation and tax advisory firms in attempts to lure investors and companies to tax havens (Fichtner 2016; Hakelberg 2016; Sikka and Hampton 2005; Sikka 2008), the Panama case studies demonstrate that the ways in which trade policies are enforced can also be a major factor. Secrecy jurisdictions have typically been quick to copy new financial 'innovations' from each other, and there is no reason to expect that the aggressive use of trade policies would be an exception.

Much depends also on how major onshore states see the trade-tax nexus. Traditionally, the United States has expressed the view that trade agreements should not impact the national tax system(s). The rationale behind this is that the interaction of tax systems should remain the subject of bilateral tax treaties. However, the EU has moved more aggressively to bring trade and tax rules into closer harmonization for a long time (McDaniel 2000, 1621). One potentially complicating factor is also that both the United States and the EU host significant tax havens.



Moreover, as noted in section two, trade policies can, in some cases, also help to curtail international tax avoidance. In the case studies we demonstrated how a 'traditional tax haven' focusing on banking and financial secrecy practices was able to use trade policies to dodge attempts for better tax regulation.

What lies in the future? Brauner suggests, that the international trade and tax regimes should be co-ordinated, even though they cannot be simply reconciled. It is easy to second this call. According to Brauner, such coordination would benefit from the establishment of an international tax organization, separate from the WTO. Such an organization should be tasked with the responsibility of making the evolving international tax regime more compatible with the international trade regime (Brauner 2005, 254). The 'disconnect' between the trade and tax regimes is seen as detrimental to the international tax regime (Brauner 2005, 258). Most countries (including the United States) do not coordinate their trade and tax regimes. As best expressed by one US scholar, '[t]his country's tax framework is about as poorly adapted to GATT as is imaginable' (Brauner 2005, 262). Recently, similar calls for international tax organization (which in itself is an old idea) have been also voiced by prominent scholars of international tax governance, such as Tanzi (2016).

Our contributions in this article are in part forward-looking. To the best of our knowledge, only Panama has used the WTO complaint route to put a curb on attempts to enforce anti-tax abuse rules. It remains to be seen when and how other tax havens will follow its example. Given the fast pace of mimicking of financial innovations in the offshore industry, it would be surprising if other tax havens remained idle while Panama vigorously defends its tax regime.

We note that further research could be conducted in at least four fields. First, the existing WTO treaties may have an impact on recent international policy measures for the regulation of international tax matters. Second, since the early 2000s, the focus of trade policy discussions has shifted from the WTO to regional and bilateral treaties. This new and more dispersed body of regulation can also have diverse impacts on international tax regulation. And third, further studies could be done on the relationship between the international tax regime and other policy areas. As for example, most of the debt conditionalities imposed by the World Bank, the IMF, and more recently by the EU typically include a myriad of tax-related provisions. Given the large number of these programs during the past 35 years, their impact on the international tax regime must also be considerable. Fourth, motifs behind Panama's actions merit further research: why and how Panama ended up choosing WTO as a platform to defend its secrecy regime?

In addition to the broad analysis of global tax governance and the role of FTAs, we suggest that the theory of new constitutionalism should also



accommodate notions rising from the analysis presented above. Specifically, 'locking in' policies should not be seen as only restricting democratic sovereignty with supranational 'constitutional' means. As we have shown, the politics of new constitutionalism in trade policy can also mean locking in the power of globalized capital by providing political tools for 'commercialized sovereigns' to resist attempts to universalize and harmonize progressive schemes within other policy fields. Thus the study of the intersections of trade and tax policy also calls for further theoretical reconsideration.

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### NOTES

1. Many of these initiatives (especially the ones related to information exchange) address also other issues than just tax-haven tax avoidance.
2. Neo-realist scholars would argue that this forum shifting is made possible by overlapping 'regime complexes' (e.g. Orsini *et al.* 2013 and Keohane and Victor 2010), which enable political players to advocate similar measures under various regimes.
3. We speak interexchangeably of tax havens and secrecy jurisdictions. Developed originally by Murphy (2008, see also Meinzer 2016, 268), the latter concept is less known but more accurate, since secrecy is the most important characteristic of tax haven structures. The choice of terms is more than semantics, not least because any meaningful definition or listing of tax havens has to take into account prevailing secrecy laws and practices.
4. See e.g. NAFTA Arbitration pursuant in chapter 20 on the matter of cross-border trucking services (File No. USA-MEX-98-2008-01), Final report of the panel, §259-260.
5. Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade, 1994.
6. In addition to small island states such as Panama, the index features also several major powers such as the United States and the United Kingdom as the City of London is also a major tax haven. The top three jurisdictions in the 2015 index are Switzerland, Hong Kong and the United States, the latter because the combination of a great importance in the world economy and

serious defects in company ownership data, publicity and international tax information exchange.

7. An exception was the post 9/11 situation, when Panama followed many other Caribbean tax havens in agreeing to exchange tax information with the United States in late 2001 and early 2002 (Sharman 2006, 74). Moreover, ITIO later changed its name to International Trade and Investment Organisation.
8. As a further detail, the Nordic group also involved the Faroe Islands and Greenland. The relatively small combined economic importance of these countries led some scholars to judge the OECD's blacklist exercise as white-washing (e.g. Sawyer 2011).
9. See Agreement Between the Government of the United States of America and the Government of the Republic of Panama for Cooperation and the Exchange of Information Relating to Taxes (2010) and Agreement Between Canada and The Republic Of Panama for Tax Cooperation and the Exchange of Information Relating to Taxes (2013).
10. We use 'Panel report' to refer to WTO (2015) and 'Appellate body's report' to refer to WTO (2016) in this subchapter. Numbers in these references refer to paragraphs in the document, not page numbers.
11. We use 'Panel report' to refer to WTO (2009a) and 'Arbitrator's report' to refer to WTO (2009b) in this subchapter. Numbers in these references refer to paragraphs in the document, not page numbers.
12. Apart from the location and adequate staffing of the ports, the indicative prices were based on market surveys.

## NOTES ON CONTRIBUTORS

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# Politics of Intra-firm Trade: Corporate Price Planning and the Double Role of the Arm's Length Principle

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## ABSTRACT

Intra-firm trade is an emerging issue. One of its key elements is the international shifting of profits, for example, through transfer pricing that big enterprises use to cross-subsidise their subsidiaries, often to avoid taxes. Accounting rules conceal much of the information about transfer pricing, reproducing secrecy and facilitating the use of administered prices. Given the prevalence of administered price setting, a significant amount of international trade cannot be meaningfully analysed as market transactions. This provokes questions about the validity of market assumptions in research on trade in particular and global capitalism more generally. Our specific contribution focuses on the role of the arm's length principle and the significance of cross-subsidisation and other forms of corporate planning in intra-firm trade. Under certain conditions, price planning by private corporations should be analysed as political rule within the economic sphere. Since the politics of the world economy is not merely related to governmental intervention, corporations should also be theorised as potentially political entities. Crossing the disciplinary boundaries between political economy and normative political theory, we suggest that the politicisation of intra-firm trade opens possibilities for creating more effective responses to price administration and for creating more democratic ways of governing the global economy.

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## Introduction<sup>1</sup>

The societal power of the corporation has become a much-debated topic in many fields from accounting and management studies to economics, tax law, business ethics, and global political economy.<sup>2</sup> Intra-firm trade has been highlighted as an increasingly important phenomenon in this growing body of research (the second section). Our contribution focuses on largely neglected aspects of intra-firm trade: namely, the impacts of the planned intra-firm prices for analyses of the global 'market' economy and the opportunities this can create for democratic politics. We argue that the dominant free-market ideology faces an anomaly, as statistics suggest that a significant part of world trade is based on pricing planned in corporate headquarters. Intra-firm trade offers a suitable starting point for understanding the political aspects of the corporate form because of its significance for global corporate-driven capitalism. We argue that understanding the political aspects of the corporation requires revising some key assumptions about the role of markets in global political economy.

In the third section, we continue by arguing that the legitimacy of hierarchic corporate control over significant aspects of society is based on concealing its political dimensions, and suggest that

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the non-market dimension of the firm has far-reaching theoretical and normative implications. Even if scholars have started to pay more attention to intra-firm trade, most analyses of the global economy tend to assume a dichotomy between politics and markets, with corporations neatly belonging to the latter. We suggest that this dichotomy should be questioned in order to understand the politics of intra-firm trade. To conclude, in the fourth section, we discuss the policy lessons of our findings. Our contributions are relevant both for developing concrete policies that would hinder illicit tax avoidance, as well as for creating space for more democratic rules of world trade. The existing reform proposals for international corporate taxation tend to pay insufficient attention to the ideological nature of these rules.

Our analysis draws from previous studies that have revealed that transactions planned in corporate headquarters constitute a significant proportion of global trade. In 1996, the United Nations (UN) estimated that one-third of world trade was conducted within transnational corporations (UNCTAD 1996). In 2004, United Nations Conference for Trade and Development (UNCTAD) assessed that half of the service trade from the United States could be considered intra-firm (UNCTAD 2004). Using 2009 customs data, the Organization for Economic Co-operation and Development (OECD) found that intra-firm trade accounted for 48 per cent of US goods imports and about 30 per cent of US goods exports (Lanz and Miroudot 2011). The authors also pointed out that

intra-firm transactions are more common among OECD countries than among emerging economies. In 2009, 58 per cent of U.S. goods imports from OECD countries were intra-firm, while only 29 per cent of US goods imports from Brazil, the Russian Federation, India, Indonesia, China and South Africa (so called BRIICS economies) occurred between related parties.<sup>3</sup>

There is plenty of direct and indirect evidence that intra-firm prices often differ from market-based prices (see, e.g. Overesch 2006, Webb 2006, Ylönen and Laine 2015).

Planning may seem a natural aspect of any strategic action. Intra-firm trade, however, involves planning of a foundational market-economy mechanism, namely prices, which can be adjusted for avoiding taxes or for hiding risk. As many authors have shown (e.g. Picciotto 1992, Overesch 2006, Sikka and Willmott 2010, Christensen 2011, Jenkins and Newell 2013, Keuschnigg and Devereux 2013, Genschel and Rixen 2014, Durst 2016, Fichtner 2016, Mehta and Siu 2016), tax authorities face enormous challenges in monitoring intra-firm trade and enforcing domestic tax laws. It is thus not surprising that aggressive tax avoidance has been highlighted as a key issue in much of the academic research on the intra-firm trade (see, e.g. Sikka and Willmott 2010, Christensen 2011, Pogge and Mehta 2016).

Intra-firm trade deviates from the basic ideals of the market economy, as it takes place between units of the same corporate entity. These non-market aspects of the firm have also been recognised by the mainstream economics and accounting scholarship.<sup>4</sup> In economic theory, the transaction costs approach pioneered by Coase (1988) has played a particularly important role in determining why it may make more economic sense to organise production hierarchically within a firm rather than through market transactions.<sup>5</sup> One dimension of the social acceptability of hierarchic organisation can be measured by the performance of the bottom line.

## The double role of the arm's length principle

How can a 'free' market be based on administered and planned prices? Since the legitimacy of the existing framework of world trade is often based on free-market assumptions, the question is also normative. One way to deal with the mismatch between the theory of markets and the reality of price planning is through artificially establishing competitive markets in those parts of the world trade that deviate from the market assumptions. To accomplish this, states have agreed on national and international norms for facilitating market-based transactions within big corporations. As regards the intra-firm trade, the two most important norms are the separate entity principle and the arm's length principle. The separate entity principle goes back to the early development of the corporate

law in the United States and Britain, as courts and legislators started to view companies belonging to a single enterprise as separate entities in front of the law (e.g. Biondi *et al.* 2007, Robé 2011, Ireland 2016). This not only facilitated the growth of the modern corporations, but it also enabled corporations to benefit from the differences between states and other territorial jurisdictions.

Championed by the OECD, and to a lesser extent by the UN, the arm's length principle dictates that whenever two parts of the same corporate entity trade with each other, they should set the prices as if they were at 'arm's length' from each other (Eden 2016).<sup>6</sup> This principle helps combine the anomaly of planned prices with an analytical framework of 'free' markets. According to Aspers (2011: 4), markets are 'constituted by two roles, buyer and seller, each standing on one side of the market, facing the other'. In this structure, the arm's length principle can function as a mechanism that helps corporations simulate or construct markets in their intra-firm trade. In practice, it is difficult to find evidence that the arm's length principle would significantly contribute to sustaining genuine, functioning markets within corporations. Instead, as we will argue in more detail below, it plays an important ideological role in legitimising non-market aspects of world trade.

Definitional ambiguities and enforcement difficulties have always restricted the applicability of the arm's length principle. Its history dates back to the US War Revenue Act of 1917 (Avi-Yonah 1995: 94), the work of the International Chamber of Commerce Conference in the 1920s (OECD 2005: 81), and the League of Nations Model Tax Conventions that prevailed during the first half of the twentieth century (de Ruiter 2012, Vega 2012). Since the early years, corporations have actively tried to shape the arm's length regime. The development of the US transfer pricing regulation is a telling example, as it was partly a result of active lobbying by large pharmaceutical companies. The 1963 Convention paved the way for the international triumph of the arm's length principle, which can now be found in most bilateral tax treaties that regulate taxation of transnational corporations (Durst and Culbertson 2003).

The arm's length principle was initially expressed in relatively general terms, and the lack of detailed rules restricted its application in many countries (Linde 1977: 82 quoted in Vega 2012: 11). When the principle started to be applied in the US courts, the first cases combined a strict application of the arm's length principle based on market comparables with ad hoc methods that allowed prices that seemed 'not unreasonable', or 'fair and fairly arrived at' (Avi-Yonah 1995: 100). This ambiguity was accentuated by the early, strict definition of the principle that focused on market comparables. Specifically, the Revenue Act of 1934 stated that the 'standard to be applied in every case is that of an uncontrolled taxpayer dealing at arm's length with another uncontrolled taxpayer' (quoted in Avi-Yonah 1995: 97). Conferences were organised already in the 1940s to tackle these problems (see Palan *et al.* 2013: 192–3).

As recently as in the early 1970s, tax auditors used uncontrolled comparables only sporadically to test compliance with the arm's length standard (Durst 2010: 24). In 1972, Rädler tellingly pointed out that 'reference to the so-called arm's length rule usually does not lead much further, since to an ever-increasing extent similar or even comparable deliveries or services are carried out only within the one multinational company'. This sporadic approach, however, did not mean that tax authorities were idle. In the United States, tax authorities contested the tax agreements of several multinational corporations from the 1930s onward, but often had to rely on other methods than using comparables. As a consequence, the emphasis shifted from the ideal of 'uncontrolled taxpayers' to using other methods to determine acceptable transfer prices.

In the 1960s, the US Treasury Regulation 1.482-2(e) described three methods for determining an arm's length price in international situations:<sup>7</sup> the comparable uncontrolled price method, the resale price method, and the cost plus method, in that order of priority. Where none of these were applicable, the courts were left free to determine their own 'fourth methods' (Avi-Yonah 1995: 107). According to Avi-Yonah, the result was 'a deliberate decision to retreat from the standard while still paying lip service to it' (1995:112). The loosening of criteria did not, however, solve the inherent problems of the principle. In 1985, the House Report on House Bill (quoted in Avi-Yonah 1995: 130) noted how

[the] fundamental problem is the fact that the relationship between related parties is different from that of unrelated parties. Observers have noted that multinational companies operate as an economic unit, and not 'as if' they were unrelated to their foreign subsidiaries. In addition, a parent corporation that transfers potentially valuable property to its subsidiary is not faced with the same risks as if it were dealing with an unrelated party.

These problems were further addressed in the United States in 1988 in a U.S. Treasury Department white paper on intercompany pricing, and the consequent 1994 revision of the US tax code. The white paper argued that the lack of comparables restricted application of the traditional arm's length principle. Methods introduced in 1968 had helped keep the system functioning, but the white paper went further in introducing the option of using profit-split methods as well, 'as long as the results reached were compatible with arm's length results' (Avi-Yonah 1995: 135). This was a significant step away from the idealised comparables and market-based prices. Major developments also took place in international forums, as the OECD Council approved the OECD's Transfer Pricing Guidelines in 1995, initially formulated in 1979. The 1995 Guidelines were an important step toward a more comprehensive normative framework, despite many problems of monitoring and enforcement remaining (OECD 2010: 3, 2013). In line with the US regulations, the OECD guidelines also allowed the use of various methods to determine taxable income where comparable prices could not be found.

While the problems inherent in the transfer pricing regulation are old, they have been accentuated as world trade has grown, characterised by its increasing concentration *within* large companies and corporate groups that operate across national borders. The recent decades have also seen a massive growth in the services trade, in tandem with a trend by which decentred corporations (Desai 2008) separate their internal wealth chains (Seabrooke and Wigan 2017) from their value chains (Gereffi and Korzeniewicz 1994, Henderson *et al.* 2002), for example, by centralising the ownership of intangible rights from several group companies to one 'Intellectual Property company', often located in a low-tax jurisdiction (see Palazzi 2011: 24).<sup>8</sup> These developments have made it even more difficult to determine the comparable market prices, even though states have begun to monitor the intra-firm trade more rigorously. The arm's length system is thus highly vulnerable to manipulation. These policy changes have been helping tax authorities and companies to go on with their day-to-day business, but they have distanced the arm's length principle far from its original purpose. Yet, as we will argue, the principle continues to play an important ideological role.

Most transfer pricing-related profit shifting is conducted with small deviations from the estimated market prices, with major impacts on the geographical distribution of income within large corporations (Seabrooke and Wigan 2017).<sup>9</sup> Companies can, however, also engage in more aggressive forms of planning, enabled by the difficulties states face in enforcing and monitoring their transfer pricing rules. De Boyrie *et al.* (2007: 474) have described how

in November 2005, a set of golf clubs is imported into Nigeria for \$4,976, while the US/World median price for the same set of clubs is only \$82. During the same month, a gasoline generator is imported into Ghana from the USA at a price of \$60,000 that could be purchased at the US/World median price of \$63.03.

Ylönen and Laine (2015) demonstrated how the major pulp and paper company Stora Enso was able to handle the invoicing of its pulp trade between Brazil and its internal customers in Europe via a subsidiary in the Netherlands, even though the pulp was shipped via Belgium. The arrangement generated 300 million of euros of profits in the Dutch invoicing centre between 2005 and 2010, with an effective tax rate of 3 per cent. The arrangement was based on the use of low transfer prices in the trade between Brazil and the Netherlands, combined with the use of market-based prices in sales from the Dutch subsidiary to the parent company.

Furthermore, determining the market-based comparable prices can be genuinely difficult for both corporations and states. Corporate secrecy and inadequate statistics make it difficult to estimate market-based prices for many commodities and services. Consequently, corporations are often unable to even roughly estimate the prices their competitors use in their internal trade. Increasing the transparency of country-level financial information through the so-called country-by-country

reporting promoted by many scholars, organisations and tax justice activists could alleviate this problem at least for tax authorities. Unsurprisingly, corporate interest groups have opposed such measures. In its broad version, the country-by-country reporting initiative would make the essential country-level financial information on transnational corporations publicly available at the company's website. At the moment, these data are scattered across national company registers whose level of openness and accessibility varies greatly (see Murphy 2009, 2016). Greater transparency would help tax authorities and the public to understand the tax avoidance arrangements, but it would not solve the underlying problems of the arm's length principle.

Consequently, we argue that the arm's length principle plays a double role. On the one hand, it is an instrument to establish markets within hierarchical corporate structures. There is enough evidence to suggest that the arm's length principle is a failure in market creation, demonstrated by the slow but steady shift of transfer pricing rules from the search for comparables to other pricing methods. Michael Durst, former director of the Advance Pricing Agreement Program of the US Internal Revenue Service, has aptly noted that 'despite many efforts at reform around the world during the 40 years or so in which the current system has played an important international role, governments have never been able to administer the system effectively'. What is more, he saw little prospect of getting the system to function in the future 'no matter how hard one seeks to reform' it (Durst 2010: 247).

There exists, however, a role in which the arm's length principle has been more successful. We suggest that the principle also helps maintain non-market planning operations within corporations. The principle offers a basis for assuming that markets exist in places where their presence is difficult to verify in practice but ideologically important to simulate in theory. In this sense, it clearly plays an ideological role. This role of the arm's length principle can be compared to another body-part metaphor, the invisible hand. As in the human body, each part has a function that sustains the whole. The invisible hand, albeit mentioned only in passing by Adam Smith in *The Wealth of Nations* ([1776] 2003: 572; see also Rothschild 1994, Watson 2005), has been constantly evoked to support the claim that market economy contributes to the overall public good.

Scholars have debated both societal and academic roles of the invisible hand from various viewpoints for decades (Rothschild 1994, Aydinonat 2008: 81–92). In world trade, the arm's length principle arguably plays an even more fundamental role, because it can be evoked to resolve the prior question of whether a market economy actually exists. Even if it is sometimes recognised that its flaws and ambiguities favour corporate interests (see Webb 2006: 110–11), the ideological role of the arm's length principle has not received the critical examination it deserves.

These monitoring and enforcement problems imply that the arm's length principle has been a failure only if we judge by its ability to create markets where they do not exist. The same difficulties, however, can be considered important elements in the success of the principle in justifying the non-market aspects of intra-firm trade, so that they seem compatible with the normative foundations of the market economy. Its success is not perfect, as demonstrated by the insufficient OECD-driven attempts to 'fix' the arm's length principle with its Base Erosion Profit Shifting (BEPS) project (OECD 2013); the increasing calls for unitary taxation; and the growing public attention to these issues. By focusing on these aspects of world trade, we hope to contribute to further understanding of the politics of price planning in big corporations.

## What does it mean to analyse corporations as systems of planning?

### *The political planning of intra-firm trade*

According to Aspers (2011: 4), a key feature of the market is that its 'actors – individuals and firms – compete with each other'. In addition, Lazonick (1991: 59) has noted how the 'definitional social characteristic of a market is the impersonal relation between buyer and seller'. Both characterise markets as dominated by independent, rival firms. In the intra-firm trade, the buyer and seller are,

however, part of the same decision-making structure. Therefore, the relationship is far from 'impersonal', and not 'competitive' in the standard market-economy sense. The veil of corporate secrecy protects intra-firm transactions, whereas the market ideal assumes that relevant information is available to all key participants. This reasoning suggests that a significant part of world trade could hardly be characterised as a market economy. There is evidence that corporate planning conducted through cross-subsidisation and administered prices is so widespread that characterising real-world global capitalism as a market economy is misleading.

Even if the simplistic market assumptions about world trade are non-realistic, planning the intra-firm trade surely also involves market considerations. If the intra-firm price of a particular good or service deviates from 'going market price', thus violating the arm's length principle, the overall price planning of the company still needs to respond to various external pressures that include undeniable market elements.<sup>10</sup> This does not, however, invalidate our hypothesis of big corporations as centralised planning entities. After all, states need to take market considerations into account in their economic planning as well. For example, trade treaties include elements that induce states to imitate markets by transforming government functions into state-owned companies (Schneiderman 2000). The prices used in this trade are also supposed to reflect market-based prices, but determining the latter is often impossible. Even in cases where governments are strongly conditioned by such rules and market signals, few would argue that this would turn them into non-political entities. This establishes our first argument for questioning any strict demarcations between markets and politics in corporate sphere, as being conditioned by markets and being political are not mutually exclusive conditions. Nevertheless, we still need to address the question of how to best define the relationship between politics and markets in the non-market setting of intra-firm trade. Toward this end, it is useful to address also terminological issues.

In the academic literature, the difficulty of determining 'true' transfer prices has been discussed using terms such as 'misuse of transfer pricing' (as in Lakhal 2006: 545), 'abusive transfer pricing' (as in Lesage *et al.* 2010: 156), 'distortion of transfer prices' (Fuest and Riedel 2010: 5), 'abnormal prices' (Fuest and Riedel 2010: 7), 'enlarged import prices' (Fuest and Riedel 2010: 17), and 'over- and under-invoiced prices' (Eden 2003: 11). Most of these terms point to an intentional agency that directly impacts price formation in intra-firm trade. Even if the value-laden nature of these terms is often forgotten, the choice of ethically loaded terms such as 'abusive' is at least potentially politicising, as it suggests that there is something else at play than the market mechanism. On the other hand, terms such as 'enlarged' or 'distorted' prices implicitly suggest that it is possible to define market-based prices. As argued earlier, this is often not the case.

The term 'profit shifting' avoids this assumption but lacks the ethical tone. Used already in the 1960s by Kaldor (1963: 20), it has recently become a popular concept, not least because of the OECD's *Base Erosion Profit Shifting* project (2013). In addition, 'profit shifting' has featured in many other publications (e.g. Development Working Group 2011, FitzGerald 2012). One way to define profit shifting is to see it as 'strategic actions taken by firms that result in profits being reported in a tax favorable jurisdiction' (Cederwall 2015). Related to this, the OECD understands base erosion and profit shifting as 'shifting profits away from the jurisdictions where the activities creating those profits take place or by exploiting gaps in the interaction of domestic tax rules where corporate income is not taxed at all' (2015: 42). However, there are two further concepts that succeed in highlighting the planning aspect of intra-firm trade, namely cross-subsidisation and administration of prices.

To recap the argument so far, we made the case that states and large corporations have more in common than prevalent dichotomies of trade research often assume. States increasingly operate under market-based assumptions. Even more importantly, non-market-based economic planning is more prevalent in large corporations than many political-economy analytical frameworks assume. Hence, there is a case to be made to analyse large corporations without the economic assumptions that associate planning only with state intervention. Both large corporations and states participate in planning the markets and marketing their plans. There are obvious differences between them,



including the territorial boundaries that delimit the potential for state action, the greater role of states as creators of binding normative frameworks, and the ability of states to declare a state of exception (Schmitt 1927, Agamben 2005). However, both governments and corporations can be rule-makers as well as rule-takers, although often in different venues and processes. At times, corporations can make their own rules directly in private regulative bodies. On other occasions, corporations influence the rules indirectly through economic planning.

Given that the ‘political’ sphere of states and the ‘economic’ sphere of corporations are more intertwined than is commonly understood, we need to ask a further question: could corporations also be conceived as political entities? We will focus on this question in the next section, arguing that the theoretical question also has practical implications. States often claim to base their legitimacy on democratic consent, whereas corporations are typically shielded from the validity sphere of democratic norms. Even though advancing better norms for international taxation can be successful within the existing conceptual frameworks, understanding corporations as political entities can also be used in arguments for more democratic international tax governance. We contribute to this important task by exploring how a realist analysis of intra-firm trade provides one avenue for this kind of politicisation.

### ***Corporations as political entities: some normative issues***

Among the multitude of debates in political theory about what it means to call an entity ‘political’, Unger’s two basic definitions of ‘politics’ (1987: 145–6) provide a helpful starting point. For him, the narrow sense of politics can be called ‘conflict over the mastery and uses of governmental power’. To analyse other than governmental politics of practices and spaces, it is more useful to rely on Unger’s broader definition of politics as ‘struggle over the resources and arrangements that set the basic terms of our practical and passionate relations’. According to Unger (1987: 145–6), the most important of these arrangements is ‘the formative institutional and imaginative context of social life’. Politics in the narrow sense represents a special case of the politics in the broader sense.

The widely acknowledged role of non-governmental actors in the ‘private’ governance of the contemporary global economy alone would favour endorsing the ‘broad’ definition. However, our primary focus is not on decision-making bodies, as the term ‘private governance’ is sometimes understood in the literature. Rather, we maintain that intra-firm planning can have major impacts on taxation, regulation, and the financial transparency of corporations. Consequently, corporations can consciously affect these ‘resources and arrangements’ by intra-firm planning. Therefore, state-centred definitions of the political nature of such planning are insufficient. Limiting the analysis of corporate power only to the influence on state actions can render other significant areas of corporate power invisible.

Before focusing in more detail on the political nature of the intra-firm planning in corporations, we should ask why bother. Is it simply a matter of definitional taste whether one considers corporate activities such as intra-firm trade to be political, or whether the term ‘political’ should be reserved for the activities of governments, as in the more narrow definition of Unger? The standard use of terms such as ‘economic planning’ and ‘political intervention in the market’ associates these activities with state governments. In addition to paving way for more efficient policy responses, the realisation that corporations practise planning and intervene politically in the markets without direct mediation by states opens up new ways to reflect on the legitimacy of many aspects of the corporate sphere. In particular, understanding corporations as potentially political entities raises questions about their democratic legitimacy. These questions, apart from their practical implications, also help expand the boundaries of political economy research toward normative political theory.

Another justification for studying corporations as political entities can be found in the basic tenet of science as an endeavour intended to increase our capacity to explain and understand reality, in this case the anomalies described in the previous sections. Within mainstream economics, there have

been influential attempts to dismiss the importance of realist assumptions in scientific research, most famously in the often-cited article by Friedman (1953). While acknowledging that non-realist simplifications may sometimes be needed in science, we suggest that the mismatch between free-market assumptions and the non-market realities of intra-firm trade has become of such a magnitude that the assumptions violate the basic tenets of scientific research.

The relative absence of these questions in the scholarship on corporations at least partially results from the division of labour between academic disciplines. Scholars in economics, accounting, management, and related fields may simply think that analysing issues of democratic legitimacy is for political scientists. Most of the well-established approaches in the fields of management and economics tend to pay little attention to the historical development of their own disciplines, and even less so to others. In political studies, questions of intra-firm trade are generally considered issues of international political economy. Research in international political economy, on the other hand, is often conducted as if it was about interactions between political and economic entities that are represented respectively by states and markets. Understanding the political role of corporations and their economic planning requires transgressing the depoliticised conceptions of the economic as a separate sphere. The concept of planning enables us to analyse corporations as political entities.

One of the main assumptions that help legitimise and reproduce corporate power is the idea we discussed in the second section, namely that democratic norms are only valid within the political sphere and not within the economic sphere (Teivainen 2002). If academic research establishes that important aspects of corporate action in fact form part of the political sphere, as we believe any serious analysis of intra-firm trade suggests, we have a case for asking political questions that may seem uncomfortable for the current power relations. Politicising an entity that has traditionally been considered apolitical reveals its potentially democratisable nature. As we will argue in the next section, this can be important, for example, when designing ways of governance of unitary taxation of large corporations.

Both political economy and radical activism have a long tradition of politicising economic issues. The tax-related issues of intra-firm trade have, however, remained without much public attention until recently. Less than a decade ago, Webb (2006: 109) noted the 'virtual absence' of non-governmental critical activism on international corporate taxation. Since then, the situation has changed, as evidenced by the appearance of tax-related scandals in the media and the visibility of tax-themed NGOs such as Global Financial Integrity and the Tax Justice Network (Seabrooke and Wigan 2016, Dallyn, in press).

Until recently, discussions on corporate social responsibility (CSR) were characterised by an almost total absence of corporate finance and tax functions (Ylönen and Laine 2015). Both the public and corporate framing of corporate responsibility leaned heavily toward the social and environmental aspects of the corporation (e.g. Golob and Bartlett 2007: 3).<sup>11</sup> In the past two decades, growing public attention to tax planning has resulted in calls to discuss tax policies 'in the boardroom' (KPMG 2006). In accounting studies, Gray and Laughlin maintained only a few years ago that 'taxation remains [here], as it does throughout much of accounting research, something of an un-explored desert' (2012: 237). This situation has been changing since the financial crisis of 2007–2009, but tax issues are still rarely discussed in detail in corporate responsibility reports (Soederberg 2010, Lee 2015). Corporations tend to dislike the emergence of tax-related aspects of intra-firm planning in the corporate responsibility agenda. One of the mechanisms to avoid it is through highlighting the various kinds of mandatory taxes they already pay, giving little meaningful information on the intra-firm dimensions of tax planning (Ylönen and Laine 2015).

In other words, there is an ongoing discursive struggle on how to frame corporate tax planning in a situation where critical debate on corporate taxation 'is out and there's no going back' (KPMG 2006: 4). Moreover, the narrow framing of the voluntary tax footprint reports suggests that corporations would rather remain silent on political aspects of corporate taxes and tax planning.<sup>12</sup> It is thus evident that the doctrine of economic neutrality characterises both corporate and scholarly discussion on tax planning (Swedberg 1986, Teivainen 2002). The corporate responsibility discourse has



partially challenged this doctrine by integrating conscious choice and social consequences into the responsibility debate.

In this context, mildly moralising terms such as over- or underpricing tend to suggest that the anomaly of wrongly priced products can be corrected by either hoping or assuming that corporations will conform to arm's length prices. While 'profit shifting' can be seen as a more neutral substitute that avoids such assumptions, we believe that 'administered prices' and 'cross-subsidisation' can be particularly useful concepts in analysing corporate power. In the 1970s, Barnett and Müller defined cross-subsidisation as 'the use of power and resources developed in one "profit center" to start or to expand another' (1974: 255), maintaining that the 'widespread use of transfer pricing so central to the cross-subsidisation strategies of the global corporation is designed, as we have seen, to create what amounts to a private economy' (277).

While we find the concept of a 'private economy' ambiguous,<sup>13</sup> the idea of cross-subsidisation captures two important dimensions of intra-firm transactions: subsidising specific parts of a business unit for market-related reasons (e.g. setting up a new business or outbidding competitors) and setting non-market transfer prices in order to gain tax related or other advantages. Cross-subsidisation includes various forms of planning that deviate from the arm's length principle, from non-market transfer pricing to debt-related arrangements. The goals vary from lower tax rates to avoiding regulation, or concealing risks.

Cross-subsidisation entails that the prices used in intra-firm trade may be 'administered' in ways that violate market principles. Means and Berle argued already in the 1930s in their seminal study of the modern corporation (Berle and Means 1934: xxxiv) that, contrary to the mainstream market theory, corporations are able to 'administer' their prices. According to Means (quoted in Auerbach 1962), an 'administered price' is 'a price set by someone, usually a producer or seller, and kept constant for a period of time and for a series of transactions', as distinguished from a 'market' price, which 'fluctuates on the basis of supply and demand as these forces are felt in the market'.<sup>14</sup>

Our framework resonates also with the idea of large corporations as enterprise entities. Drawing partly on early evolutionary economists, Yuri Biondi and others have argued in recent years that while the group companies of multinational enterprises are treated as individual legal entities in jurisdictions where they operate, in reality these large corporations plan their activities as unified enterprise entities. According to Biondi and others, many of the difficulties in taxation and regulation of large corporations result from this mismatch between their legal treatment and their internal operational logic (Biondi *et al.* 2007, Biondi 2013). In a way, the enterprise entity approach and our framework complement each other, as they illuminate different aspects of corporate planning and its effects.

Our framework can also help deepen the understanding of concepts such as 'illicit financial flows'. Baker (2005: 23) has used the terms 'dirty money' and illicit money interchangeably, defining the former as money 'that is illegally earned, illegally transferred, or illegally utilised'. Consequently, the term 'illicit financial flows' has become widely applied in the development and tax policy communities. From the planning viewpoint, illicit flows can include various degrees of lawlessness conducted by the administering of prices. In the case of states, we have become accustomed to attaching labels such as endemic corruption or rule by the mafia to situations where one group in society is constantly bending the laws. However, we maintain that the strict separation of market and politics hampers our ability to see the similarities between the use of power in these two realms when we address similar situations in the corporate realm. Finally, it should be noted that from a normative perspective analysing corporations as potentially political entities can also have ambiguous implications, as it can lead also into situations where corporations are granted political rights without any responsibilities of political accountability.

To recap, we started by presenting the case that much of world trade takes place under conditions that the market-based lexicon captures poorly. We argued that the intra-firm trade could be analysed using the concepts of corporate planning, administration of prices, and cross-subsidisation. We also maintained that this planning and cross-subsidisation can give corporations power to affect the 'resources and arrangements' in states and societies where they operate, relying on Unger's broad

definition of politics. Consequently, we believe that there are grounds to analyse not only states but also corporations as political actors.

This does not mean that all corporate planning, price administration, and cross-subsidisation could be considered equally political. Even though many individual, isolated decisions collectively affect the resources and arrangements in societies, not all these decisions should therefore be subjected to political norms such as democratic accountability. For example, one could think of a large corporation that operates in a small state and forms a significant part of the economic activities within that state's jurisdiction. There are significant reasons to consider the corporation as political if it uses its planning power to conceal significant risks or to deprive the state of the revenues it is legally entitled to. The precise borderlines between markets, planning, and political planning clearly require further research.

Another point of interest is how easily corporations can circumvent national tax laws. While there are many countries where companies can violate environmental or labour legislation, it is difficult to think of an area where it is so common to break the spirit of the law as in tax payments. States are often incapable of effectively implementing the corporate tax laws that are supposed to condition the 'resources and arrangements' of corporate affairs. Meanwhile, there are occasions on which corporations can use the commercialised sovereignty (Palan 2003) of tax havens to circumvent tax laws in other countries. Even more importantly, corporations can circumvent national tax laws or other regulations by cross-subsidising their subsidiaries in low-tax and high secrecy jurisdictions.

### From the arm's length principle to unitary taxation?

Today, the efficiency of the arm's length principle is debated more than ever (e.g. Eden 2016). The principle has failed in its declared goal of establishing markets within large companies. The principle, however, also has another, much less discussed ideological role that helps legitimise international corporate tax governance. We argued above that this legitimising role could be compared to discussions on the concept of 'invisible hand'. We pointed out that while there is a huge body of critical discussion on the invisible hand, there has hardly been any discussion on the normative implications of the arm's length principle. Consequently, we call for scholarly attention to these aspects. Relying on Unger's broader definition of politics as 'struggle over the resources and arrangements that set the basic terms of our practical and passionate relations', we also argued that in order to understand corporate planning, it is important to focus on how it constitutes a political dimension in corporate affairs.

The first step in recognising the double role of the arm's length principle is realising that the idea of using market-based comparable prices in intra-firm transactions has never been a success. The de facto rules of intra-firm trade have allowed using other mechanisms than comparable pricing at least since the 1960s. From the 1990s onwards, the applications of the arm's length principle have moved even further from the market. While the use of comparable prices is still the first pricing method in the transfer pricing guidelines, it has long been overshadowed by other pricing mechanisms such as the cost plus method and the resale price method.

We acknowledge the work of many scholars who have analysed these issues (e.g. Avi-Yonah 1995, Durst and Culbertson 2003, Biondi *et al.* 2007, Ireland 2016) and the emerging discussion on the planning aspects of transnational corporations (Pistor 2014, May 2015). Nevertheless, the arm's length principle is often discussed with an assumption that it is possible, at least in theory, to identify market-based prices. Bandyopadhyay (2012: 111) suggests that preferred price should be a 'fair one, that is, a price that would be charged between the parent and subsidiary companies, as if they are "unrelated companies"'. This fairness is often not achieved, he continues, since 'companies often manipulate the transfer price to escape taxes'. Essentially, this formulation can create the impression that it is generally possible to determine comparable prices but that they are currently subject to manipulation.

Similarly, Keuschnigg and Devereux (2013) maintain that ‘tax authorities typically apply the arm’s length principle in corporate taxation and use comparable market prices to “correctly” assess the value of intra-company trade and royalty income of multinationals’. As a third example, Jenkins and Newell (2013: 390) recommend that companies should ‘commit to using arm’s length pricing in all transactions with related parties as recommended by the OECD Guidelines on Multinational Enterprises’. They then note that it is not ‘always easy to establish arm’s length prices for all transactions’, but point out that there are regularly updated principles laid out in the OECD Guidelines that guide this process. One of our main arguments is that a fine-tuning of these principles is unlikely to result in market-based transfer prices, as the arm’s length principle is inconsistent with the ways corporations plan their internal transactions. Therefore, we call for careful attention to the double role of the principle and its implications for markets.

Understanding the ambiguities in current transfer pricing regulations and their various methods helps demystify intra-firm trade and opens up discussions on both more efficient alternatives and on their more democratic governance. Regarding the former, we believe that recognising the role of artificial formulas and estimations in currently existing intra-firm pricing is useful for discussing unitary taxation (e.g. Cockfield 2004, Avi-Yonah and Benshalom 2011, Avi-Yonah 2016, Picciotto 2016). Under unitary taxation, the global taxable income of corporations would be divided by a method called formulary apportionment between the jurisdictions where the company has genuine operations (Avi-Yonah *et al.* 2009). This is not a new idea, as the United States applies formulary apportionment between its states. Neither would the arrangement have to be global – it would also be possible for a smaller group of countries to pave the way. The arm’s length principle and formulary apportionment are not mutually exclusive systems but more like two ends of a continuum (Avi-Yonah 1995). The key issue is, therefore, to tackle the ideological assumption that it is possible to create markets within firms. As soon as we abandon this presumption, it will become easier to conduct meaningful analytical debates on what kinds of formula we should use for dividing the part of the added value created by corporations that belongs to the states.

Real unitary taxation would help the task of addressing corporations as centrally coordinated entities (Biondi 2013). It would take some of corporate planning out of private hands and make it an issue of global governance by adopting an internationally agreed formula to divide the taxable income from transnational corporations between the states where they operate. This would strengthen economic planning by states over corporations, as each state would get a share of corporate tax revenues based on a formula derived from the company’s accounts. In less state-centric possible futures, other actors could also participate in norm building or receive corporate tax incomes. Understanding large corporations as global planning entities gives weight for demanding global or regional (e.g. an EU-level) decision-making of their tax matters, possibly through channelling parts of the revenues into regional or global funding mechanisms.

The discussions of unitary taxation have evolved rapidly in recent years. In September 2013, the G20 group stated in its St. Petersburg summit declaration that ‘profits should be taxed where economic activities deriving the profits are performed and where value is created’ (G20 2013: 12). While this was not an outright endorsement of unitary taxation, it gave more weight to similar demands. The international efforts to tackle corporate cross-subsidisation have centred around the OECD’s BEPS initiative complemented by initiatives of the EU and the OECD (Eccleston and Smith 2016). It is evident, however, that these initiatives fall short of fixing the underlying problems.

The more opportunities corporations have for shaping the ‘resources and arrangements’ of the places where they operate, the more vulnerable they may also become to demands to bring their operations under more public scrutiny and accountability. Unitary taxation would diminish the current opportunities for corporate tax planning and expand the sphere of public planning. Although in itself this would not necessarily lead to a significantly more democratic system of global tax governance, it could provide new opportunities for establishing state-led or otherwise democratic alternatives to corporate power.<sup>15</sup> Among other things, the policy responses depend on how well the corporate planning power we have described in this article is understood.

## Concluding remarks

Depending on the formula and its application, unitary taxation could significantly diminish corporate non-market planning. The most likely short-term impact would be an increase in the overall planning power of states, but only as a result of international negotiations. The discrepancies in power between states would most likely affect the outcome of the formula, favouring some states over others. By reaching an agreement on the formula, states could significantly restrict the scope of 'tax wars' between nations (Christensen and Shaxson 2016), as states would delegate some of their planning power on corporate taxation to the international bodies. Effectively, with formulary apportionment, much of the current corporate planning related to intra-firm transfer pricing could be rendered useless.

On the other hand, partial solutions to the problems of transfer pricing may lead to ideological biases not unlike the double role of the arm's length principle. This has already been evident in the significant expansion of advance pricing agreement (APA) programmes in various countries. APAs are essentially tools that companies use to negotiate transfer prices before applying them. Companies give up some of their planning power in exchange for reducing possible tax litigation risk. Moreover, as the LuxLeaks scandal of 2014 demonstrated,<sup>16</sup> the APAs can also be used for aggressive tax planning and in order to avoid taxes in other countries. While by no means a panacea, multilateral negotiations for genuine unitary taxation could be an effective way of dealing with the issues of corporate planning that we have explored in this article.

A crucial question for any alternatives is the direction the recent public interest will take. Should the public interest in tax governance issues wane, the political momentum will most likely suffer as well. We hope this article can participate in opening new ways to connect the often-technical debates on intra-firm trade with more fundamental normative questions. In particular, we hope our focus on the mismatch between the market assumptions of the arm's length principle and the reality of non-market planning in intra-firm trade can contribute to increasing public attention and political pressure. If the academics, policy-makers, and social movements are not aware of the normative implications of the terms they use, they run the risk of letting these normative aspects guide their messages and analyses. A more realist conceptual understanding of the non-market elements of world trade can be helpful also for putting democratic norms into practice.

## Notes

1. An early version of this article won the 2015 Amartya Sen Prize in a contest organised by Yale University, together with Global Financial Integrity and Academics Stand Against Poverty.
2. Some key contributions in business ethics studies are Doyle *et al.* (2009), Huseynov and Klammer (2012), Muller and Kolk (2015), Preuss (2010, 2012), and Weyzig (2013). In political economy, see, e.g. Christensen (2011), Christensen and Murphy (2004), Dietsch and Rixen (2016), Jenkins and Newell (2013), Leaman and Waris (2013), May (2015), Otusanya (2011), Palan *et al.* (2013), Pogge and Mehta (2016), Rixen (2011), Seabrooke and Wigan (2017), and Webb (2006). For discussions in economics, see, e.g. Clausing (2003), Desai and Dharmapala (2006), and Haufler and Schjelderup (2000). In accounting, see, e.g. Hasseldine and Morris (2013), Sikka (2013, in press), and Sikka and Willmot (2010). In legal scholarship, see, e.g. Avi-Yonah (1995), Durst and Culbertson (2003), Eden (2016), Ireland (2016), and Picciotto (2016).
3. In its 2002 Economic Outlook, the OECD also gave an important estimate that "Across all OECD countries ... intra-industry trade in more sophisticated products such as chemicals or machinery and transport equipment is typically around 60 or 70 per cent, whereas for manufactured goods involving simpler transformation processes, such as food products, it is typically around 40 per cent or less" (OECD 2002: 161). In the same year, the *OECD Observer* magazine also stated that approximately 60 per cent of the world trade is intra-firm (Neighbour 2002).
4. Horngren *et al.* (2012: 773) note in their widely used textbook of managerial accounting that 'top management uses transfer prices (1) to focus managers' attention on the performance of their own subunits and (2) to plan and coordinate the actions of different subunits to maximise the company's income as a whole', also noting that 'managers of different subunits often have very different preferences about how transfer prices should be set'.

5. Many of the key benefits of hierarchically organised operations supposed by the transaction cost theory, such as lower transaction costs and economic efficiency, are based on assumption that companies do *not* operate internally according to market mechanisms (Avi-Yonah 1995: 148).
6. The concept of 'arm's length' is also used in many other contexts, meaning 'avoiding intimacy or close contact' according to the *Oxford Dictionary of English Idioms*. In political economy, it is sometimes applied when discussing such matters as borrowing (Agarwal and Hauswald 2008) or international production networks (Kimura 2006), but the concept also appears in studies of arts funding (Madden 2009).
7. This should not be confused with corporate taxation in trade conducted within the United States, where the tax revenue belonging to individual states is determined using formulary approach. See, e.g. Clausing (2014).
8. Intellectual property rights can also be exploited in many other ways. See, e.g. Dharmapala (2008), Graham and Tucker (2006), Grubert (2003), and Rixen (2011).
9. Recently, a growing body of statistical research has emerged on this issue. In their article focusing on the 2011 financial accounts of S&P 500 companies, Heckemeyer and Overesch (2013) estimated that 72 per cent of their profit shifting took place using non-financial (e.g. typically transfer-pricing-related) channels. For a review of other relevant research, see, e.g. European Commission (2015).
10. As, for example, providing reliable information on performance of different geographical and business segments interests not only tax authorities, but also investors (Horngren *et al.* 2012).
11. However, it is interesting to note that responsibility aspects of taxation are mentioned in Howard Bowen's foundational CSR book *Social Responsibilities of the Businessman* (1953: 207).
12. The tax footprints often focus on the indirect taxes paid by the corporations with little or no attention to the importance of tax planning.
13. There is a danger that it may be interpreted as a closed *but* market-based system (in contrast to the planning system that regularly violates market principles), even though Barnett and Müller probably did not mean this.
14. Elsewhere, Means argued that 'market' prices are to be found only in agricultural commodities and some raw materials, whereas most industrial prices, many retail prices, and most wage rates are 'administered' (quoted in Auerbach 1962: 144). In the US Senate antitrust hearings of 1957–1961, Means also maintained that "administered" prices should be of special concern to the Subcommittee because the greater the concentration, the less the restraint upon pricing discretion imposed by market forces and the greater the possibility of the abuse of discretion' (quoted in Auerbach 1962: 144).
15. On transnational democratic non-state politics, see Teivainen and Trommer (2017).
16. The LuxLeaks scandal centred on a massive leak of APAs from Luxemburg drafted by the Big 4 auditing firm and published by the members of ICIJ, the International Consortium for Investigative Journalists.

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## **Policy diffusion within international organizations**

A bottom-up analysis of International Monetary Fund tax work in Panama, Seychelles, and the Netherlands

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**Abstract:** I analyse the evolution of the International Monetary Fund tax policy advice in three countries commonly used for tax evasion or avoidance: Panama, Seychelles, and the Netherlands. A review of loan agreements and Country Reports covering 1999 to 2017 highlights the dependence of the Fund's country teams on external assessments produced by the Fund's other departments and smaller international organizations. Insofar as the Fund has paid attention to international tax flight, its focus has largely been on individual-level tax evasion instead of corporate tax avoidance. The responses have been inconsistent, with the tax haven regime of Seychelles getting much more attention than Panama and the Netherlands.

**Keywords:** International Monetary Fund, Financial Action Task Force, OECD, tax avoidance, tax evasion, sovereign debt

**JEL classification:** F23, F33, F34, F53, F55, H26

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# 1 Introduction

I analyse the evolution of the International Monetary Fund (IMF) tax policies through a multiple case study (Yin 2003: 46) of three key countries often used for global corporate tax avoidance or individual tax evasion. The first country is Seychelles, which is used for both corporate holding company structures and individual tax evasion. The second country is Panama, whose role in international tax evasion was highlighted in the Panama Papers scandal in 2015. Both countries host export processing zones, which facilitate harmful tax competition by offering foreign companies special tax rates and other exemptions (Farole and Akinci 2010). The third country is the Netherlands, a major hub for holding company structures for large multinational enterprises (MNEs). While representing only a small portion of the IMF member states, they provide important insights into the effectiveness of the IMF in its work against corporate tax avoidance and evasion.

These issues could hardly be more topical, highlighted by information leaks from various tax havens. Recently, the high-profile Base Erosion and Profit Shifting (BEPS) project of the Organisation for Economic Cooperation and Development (OECD) has generated attention, although resulting only in modest reforms. International tax flight has also emerged as a development policy concern in various international organizations (IOs) (e.g. High Level Panel on Illicit Financial Flows from Africa 2015; Reuter 2012) and in the Agenda 2030 development goals. The IMF also started to focus on these issues gradually from 2011 onward. However, my case studies demonstrate that the IMF policy advice has been inconsistent and insufficient. The deficiencies in the IMF policy advice for Panama and the Netherlands are grave enough for arguing that, so far, the IMF has not managed to live up to its new commitments.

I utilize the case studies to highlight under-researched aspects of policy diffusion in world politics generally and in global tax governance (Dietsch and Rixen 2016) more specifically. The past decades have seen an emergence of constructivist literature on IOs (e.g. Barnett and Finnemore 2004) and how they can teach new norms to member states, using shaming, persuasion, and praise (Finnemore 1993). Similarly, plenty of research has emerged in international relations (IR) on how policy convergence and policy diffusion<sup>1</sup> affect IOs (for a review, see Marsh and Sharman 2009). However, these studies have suffered from ‘an excessive preoccupation with Western countries’ (Marsh and Sharman 2010: 270), and little attention has been paid to how IOs themselves ‘consume’ norms produced by other actors (Park 2005, 2006).<sup>2</sup>

My case studies contribute to these discussions in several ways. The first is methodological; there has been little qualitative country-level research based on the IMF policy documents, and I argue that this approach has much potential. Second, I demonstrate how imposing new high-level policy obligations through major generalist IOs (in this case, the IMF) can increase the dependency of their country teams on assessments of smaller, thematically focused IOs. Third, the case studies show how new policy commitments imposed on an IO such as the IMF can increase the dependence of country-level teams with the other departments of that IO. Together, these trends

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<sup>1</sup> Dolowitz and Marsh (2000: 5) define policy convergence as a process by which ‘knowledge about policies, administrative arrangements, institutions and ideas in one political setting (past or present) is used in development of policies, administrative arrangements, institutions and ideas in another political setting’. Diffusion, on the other hand, focuses typically on inter-state processes (Simmons and Elkins 2004: 171).

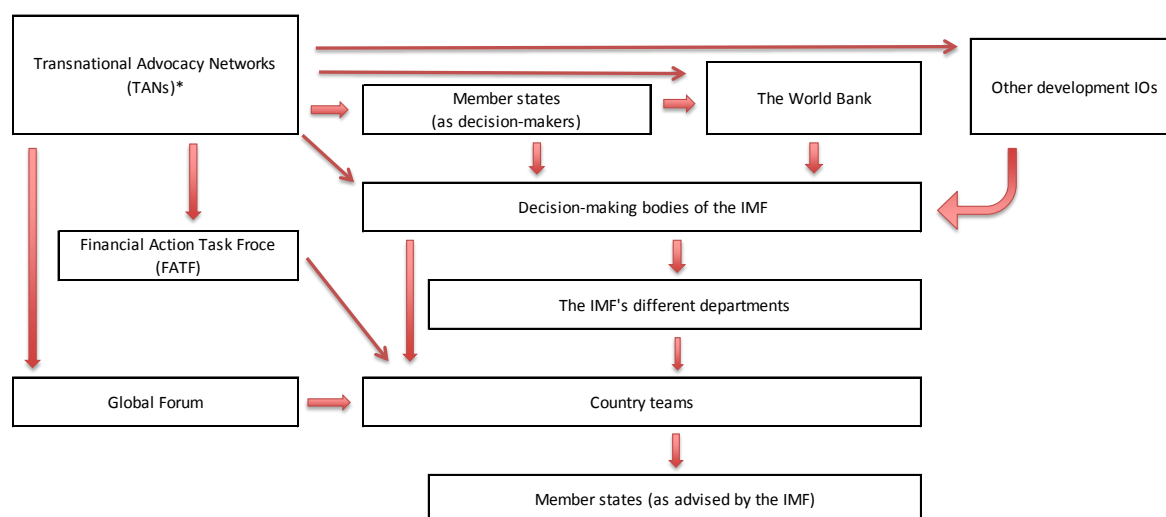
<sup>2</sup> As a rare exception, Nielson and O’Keefe (2010) have argued that in some instances IOs can consume norms produced by other IOs, highlighting how emulation may play an important role in norm diffusion between IOs.

demonstrate the importance of interplay between consumption of ideas both from outside and inside the IMF. This mix of causal and arbitrary factors behind the case studies further highlights the importance of ‘seeing like an IO’ in any attempts to understand these kinds of phenomena (Broome and Seabrooke 2012), in contrast with the mainstream conception of the IMF as ‘an institution that responds to the interest of its key members, such as the US’ (Seabrooke 2012: 3; see also Koremenos et al. 2001).

Specifically, the case studies highlight the dependence of the IMF country-level tax policy advice on assessments based on criteria developed by the Financial Action Task Force (FATF), the Global Forum on Transparency and Exchange of Information for Tax Purposes (hereafter Global Forum) of the OECD, and other bodies. Established in 1989, FATF is an inter-governmental body currently with 37 member countries. Several regional bodies also oversee the FATF recommendations. The Global Forum is the successor of a forum created in the early 2000s, when the OECD started addressing non-cooperative tax havens. Both organizations conduct peer reviews of their members, with the FATF focusing on anti-money laundering (AML) and the Global Forum on the implementation of standards on tax transparency and tax information exchange.

The IMF’s reliance on these bodies underlines the cataclysmic role of the IMF in the policy consensus facilitated by thematic IOs. At best, its policy advice has been as good as the underlying criteria. This highlights the importance of diffusion *between* IOs and the importance of policy assessments in world politics. The underlying dynamic is highlighted in Figure 1, which describes the key mechanisms through which international concerns related to international tax avoidance and tax evasion have emerged in the IMF Country Reports. While it describes these influences only one-directionally and does not include all possible linkages, it still highlights the complexity of the underlying phenomena. I will analyse its components in the country studies after discussing key definitions and measurements in the next subsection.

Figure 1: Simplified influence map of key actors



Note: \* On the role of TANs in global tax governance, see Dallyn (in press) and Seabrooke and Wigan (2013).

Source: Author’s illustration.

## 1.1 Definitions and estimations

According to the OECD, tax avoidance intends to reduce ‘tax liability and ... although the arrangement could be strictly legal, it is usually in contradiction with the intent of the law it purports to follow’ (OECD 2017). It is the key concern in the corporate sector, where even

successful court cases rarely fall under criminal law. Tax evasion, which is illegal, is more relevant to individual investors. Both phenomena benefit from tax havens, or secrecy jurisdictions (Picciotto 1992). While no single commonly agreed set of criteria for a tax haven exists, the 1998 landmark report *Harmful Tax Competition: An Emerging Global Issue* (OECD 1998: 27) identified four key factors: no or low effective tax rates, ‘ring fencing’ the offshore market from the domestic economy,<sup>3</sup> lack of transparency, and lack of effective exchange of information. The OECD’s first initiative was sidelined, partly as a result of lobbying by Panama and other Caribbean tax havens (Sharman 2006). Subsequently, several attempts towards listings of tax havens have emerged (Kudrle and Eden 2003). To highlight one such attempt, the Tax Justice Network’s Financial Secrecy Index weighs various secrecy features against the importance of a given jurisdiction in the global economy and finance (Tax Justice Network 2015).<sup>4</sup> However, the ‘havens’ for corporate tax avoidance do not necessarily rely on secrecy. Countries such as the Netherlands offer special tax exemptions and a network of bilateral tax treaties that allow easy repatriation of profits (Weyzig 2013).

Both tax avoidance and evasion are related to illicit financial flows, which have been defined as ‘money that is illegally earned, transferred or utilized’, originating from: 1) commercial tax evasion, trade misinvoicing, and abusive transfer pricing in intra-firm trade; 2) criminal activities; and 3) governmental corruption (High Level Panel on Illicit Financial Flows from Africa 2015). While the poor quality or unavailability of data from tax havens and some other countries makes estimating magnitudes difficult, some notable attempts exist. Comparing differences in foreign direct investment stocks, the United Nations Conference for Trade and Development (UNCTAD) has estimated that the tax revenues that developing countries receive from investments are some 1–1.5 percentage points lower when they are routed through low-tax jurisdictions. Based on this, it assessed the losses to inward investment stocks directly linked to offshore hubs for developing countries to be in the scale of US\$100 billion of annual tax revenue (UNCTAD 2015: 200–03). Despite uncertainties,<sup>5</sup> this is one of the most reliable estimates. However, it does not include tax losses from intra-firm financing arrangements or individual-level tax evasion.

The rest of the paper unravels as follows. Section 2 discusses the country-level policy work of the IMF. Section 3 discusses the IMF’s tax work and the slow evolution of the IMF’s alignments related to tax avoidance and evasion. Section 4 focuses on the case studies. Section 5 mirrors the key findings to the established literature on the IMF and IOs. I conclude in Section 6 by discussing the limitations of the study and avenues for further research.

## 2 The IMF country-level work and loan conditionalities

The IMF advises its members states in relation to its loan programmes and as an ongoing activity, and the ‘soft power’ of the IMF can influence national legislations even in non-indebted countries (Schäfer 2006). It also gives a green light to loan programmes managed by the World Bank. As the 2010 Article IV report from Panama (IMF 2010a: 4) notes, the ‘staffs of the World Bank and the IMF are working in close collaboration, including frequent exchange of data and information and coordination of policy advice’. Conditionalities are stipulated in the Letters of Intent (LoI) papers negotiated by the IMF staff and the debtor countries. They are accompanied by Technical Memoranda of Understanding, which specify the loan terms. They often include structural

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<sup>3</sup> Typically this means offering lower tax rates on certain incomes only to foreign investors or companies.

<sup>4</sup> The IMF mentioned the Financial Secrecy Index in at least one recent report on Panama (IMF 2016b: 17)

<sup>5</sup> For example, there may also be non-tax related reasons for these differences.

benchmarks with specific conditionalities that should—in principle—be met for future disbursements. The monitoring takes place mostly through the Article IV missions, which are also the main tool for policy monitoring and advice in other IMF member states. In addition, country teams and other IMF departments occasionally issue policy-relevant thematic reports. The focus of the IMF policy conditionalities has increasingly shifted to more subtle forms of guidance.

The IMF's work is based on its Articles of Agreement (hereafter the Articles), originally negotiated at the Bretton Woods Conference in 1944. They stipulate that the IMF should promote 'international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems' and facilitate 'the expansion and balanced growth of international trade', contributing 'to the [...] development of the productive resources of all members as primary objectives of economic policy' (IMF 2016 [1944]: 1). Finally, the important Article IV states (IMF 2016 [1944]: 6), 'the Fund shall oversee the international monetary system in order to ensure its effective operation, and shall oversee the compliance of each member with its obligations under Section 1 of this Article'. Interestingly, one could argue that the statement of purpose section could provide a relatively strong mandate for addressing the problems created by international tax avoidance and evasion, given their major impact on international trade flows.

Loan conditionalities have been a heated political topic since the Mexican debt crisis escalated in 1982.<sup>6</sup> Recently, they have also emerged as a prominent research topic, often by utilizing large datasets to analyse macroeconomic conditionalities, in contrast to the case study approach in this paper. The most extensive study reviewed more than 55,000 individual loan conditionalities from 1985 to 2014 (Kentikelenis et al. 2016). Referring to an IMF study from 2009, researchers concluded that 'the IMF's claim that programmes now "creat[e] policy space" by exhibiting "responsive design and streamlined conditionality"' is not accurate (Kentikelenis et al. 2016: 24). Other studies by academics (Gabor 2010; Güven 2012), IOs (Ortiz and Cummins 2013), and non-governmental organizations (Griffiths and Todoulos 2014; Muchhala 2011; Weisbrot et al. 2009) have reached similar conclusions.

The IMF's Independent Evaluation Office (IEO) has also highlighted the IMF's failures and tainted reputation in much of the developing world and its ill-tailored responses in financial crises (IEO 2014: 1). The IEO has concluded that extensively used policy conditionalities from 1995 to 2004 'had little structural depth and only about half of them were met on time'. What is more, compliance correlated only weakly with progress in structural reform (IEO 2008: 1), with the key determinant for real change being country ownership and the proximity of the conditionalities to the IMF's core agenda (IEO 2008: 1). Another IEO report noted that effective policy advice requires 'overwhelming intellectual leadership', which demands 'a perception that the Fund speaks as an authoritative and unbiased source of knowledge and policy advice' (Bernes 2014: 2). However, the IMF has been 'increasingly viewed as having a limited role with respect to emerging markets' (Bernes 2014: 2), and 'the Fund paid too little attention to the technical expertise and other skills that might have added value, and neglected to manage pressures that staff felt to provide overly cautious country assessments' (IEO 2009: 1; see also IEO 2014).

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<sup>6</sup> This began the period of infamous structural adjustment programmes and associated Washington Consensus policies (Williamson 1993; Rodrik 2006), characterized e.g. by a focus on state failures, deregulation of trade and finance, and privatizations.

### 3 The slow rise of anti-tax avoidance and tax evasion agendas

The long-term omission of international tax avoidance and evasion in the IMF policy advice is important not least because of the IMF's role as the 'number one driver of the tax reform agenda', and its central role in the 'epistemic community of tax professionals, which includes employees of national tax administrations and of international organisations', supported by 'economists, accountants and lawyers specialising in taxation in academia and in consultancy organisations' (Fjeldstad and Moore 2008: 238–40). The IMF's impact is most apparent during crises, but it has also been 'a major source of expertise, ideas and publications on tax reforms' (Fjeldstad and Moore 2008: 238). As Adam and Bevan (2001: 60) have argued, 'during recent decades, a powerful consensus has developed [...] [which] has included not only the structure of taxes, but also the level of tax rates'. This 'global tax consensus' (Cobham 2007; see also Christians 2010; Emran and Stiglitz 2005; IMF 2011a: 4) has stressed first the neutrality of the tax system, second, the need 'to pursue redistributive goals (if any) via expenditure not taxation, and third, to achieve revenues of the order of 15–20% of GDP' (Cobham 2007: 3). Or, as Moore (2004: 21) argues, the IMF has advocated 'fewer taxes, fewer rates for individual taxes, fewer exemptions, and less discretion on the part of the tax collector and therefore a reduction of the attendant incentives for corruption'. In a report covering the years the 1998 to 2008, Marshall (2009) (see also Damme et al. 2008) examined the IMF tax policy advice in Sub-Saharan African countries, highlighting:

- reductions in the rates of corporate and, to a lesser extent, personal income taxation,
- trade liberalization (reduction of export and import taxes),
- the introduction or expansion of sales taxes (VAT in particular), often including regional harmonization,<sup>7</sup>
- the reduction of the number of incentives and exemptions, and
- the structural overhauls of tax administration.

The most frequent recommendation concerned trade deregulation: nearly 60 per cent of IMF papers suggested reducing import tariffs while almost 22 per cent promoted reducing export taxes (Marshall 2009: 10). According to a working paper published by IMF researchers, the results have been 'troubling': 'revenue recovery has been extremely weak in low-income countries' which 'have recovered, at best, no more than about 30 cents of each lost dollar' (Baunsgaard and Keen 2005: 1).

After years of inaction, the IMF has slowly started to address the international structures and mechanisms of tax flight. In 2016, the IMF's Managing Director, Christine Lagarde, saw 'toxic' tax avoidance and tax evasion as 'major concerns'. What is more, she argued that 'the initiative to launch and complete the BEPS and automatic exchange of information' needed to be continued with 'yet a second wave of momentum [...] followed up by delivery, which is something we all need to work on' (Lagarde 2016). In 2011, the IMF co-authored a report *Supporting the Development of More Effective Tax Systems* (IMF et al. 2011), written for the G20 group in collaboration with the OECD, UN, and the World Bank. It reflected 'a broad consensus among these staff' (IMF et al.

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<sup>7</sup> First introduced in France in 1948, today more than 140 countries have adopted a value added tax (VAT) (Keen 2013). By the early 2000s, some 90 per cent of Sub-Saharan African countries had a value added tax (Christians 2010: 257).



2011: 1) and introduced several action points. Among other things, it called for deepening international cooperation, including spillover analyses ‘of the impact of any significant changes in our own tax systems on those of developing countries’ (IMF et al. 2011: 13), ‘for example in trade and international taxation’ (IMF et al. 2011: 30). Moreover, the report underlined the collective commitment to strengthen ‘programmes to assist developing countries to effectively implement transfer pricing rules, in the context of their broader tax administration capacity development efforts’ (IMF et al. 2011:13).

Similar statements have been issued by the International Monetary and Financial Committee (IMFC) and the Development Policy Committee (DPC)—the key joint decision-making forum of the World Bank and the IMF. Whereas the IMFC communiqués published in 2001 to 2012 only vaguely mention ‘domestic resources mobilization’, most communiqués from 4/2013 onward have highlighted the importance of tackling illicit financial flows, tax avoidance, and tax evasion.<sup>8</sup> Communiqué 4/2013 (International Monetary and Financial Committee 2013a) argued that ‘Fighting tax evasion is critical to help strengthen fiscal resilience of all our member states. In this regard, we are determined to promote transparency in the tax, AML and counter-financing of terrorism areas’. Tax avoidance was also mentioned in Communiqué 10/2013 (International Monetary and Financial Committee 2013b), which called on the IMF ‘to examine these issues as part of its bilateral and multilateral surveillance, and to work in collaboration with other international institutions’. In April 2014, the IMFC noted the need to enhance data provision, ‘fiscal transparency, and fight cross-border tax evasion and tax avoidance’, as well as improving ‘the transparency of beneficial ownership of companies and other legal arrangements, including trusts’. In the Development Policy Committee, Communiqué 10/2015 welcomed the joint World Bank-IMF efforts to ‘build capacity for developing countries, including on international tax issues’, and Communiqué 10/2016 highlighted the need to ‘foster policies and transparent institutions that advance’ the mobilization of domestic resources and that address illicit financial activities (Development Committee 2015a, 2016).

Another key report was a discussion note called *From Billions to Trillions: Transforming Development Finance Post-2015 Financing for Development: Multilateral Development*, prepared jointly by the IMF, the World Bank Group and regional development banks for the April 2015 meeting of the Development Committee (Development Committee 2015b). The purpose of this note was to develop ‘a preliminary vision for the collective role of our institutions’ (Development Committee 2015b), highlighting several initiatives for fostering tax-related work in the IMF. The note underlined the problems created by BEPS of large MNEs and the negative impacts of spillover of tax policy measures from one country to another, underlining the need for exchange of information between tax administrations and the tackling of illicit financial flows. Finally, it emphasized the importance of expanding policy guidance and technical assistance for domestic resources mobilization.

The Addis Tax Initiative declaration that the IMF co-designed some months later went much further. In addition to the IMF, World Bank, and the Asian Development Bank, the signatures included 37 countries, private foundations, and other IOs such as the OECD and African Tax Administration Forum. They wanted to expand cooperation in ‘enabling partner countries take advantage of the progress made on the international agenda’, such as the BEPS project and tax information exchange, ‘integrating partner countries in the global tax debate’, improving the ‘taxation and management of revenue from natural resources’, and a range of other matters (The Addis Tax Initiative 2015: 2). Furthermore, it emphasized ensuring that domestic tax policies support domestic resource mobilization by ‘applying principles of transparency, efficiency,

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<sup>8</sup> See full list of Communiqués from 2000 to 2017 in Annex I.

effectiveness and fairness’ (The Addis Tax Initiative 2015: 3). The signatories agreed ‘to enhance cooperation to combat tax evasion, fight corruption, tackle illicit finance, and promote good financial governance, transparency and accountability’. Finally, they committed to measure progress by specific targets and indicators (The Addis Tax Initiative 2015: 4). So far, one concrete outcome has been the establishment of two new joint trust funds in 2016, with a focus on revenue mobilization and managing of natural resource wealth (IMF 2016a).

In other words, a framework for gearing up the IMF work along these themes has been in place from 2011, and increasingly so in later years. However, the key question is, whether and how these alignments have been implemented at the country level. In order to get beyond motivational speeches and policy statements, I turn to the case studies.

## **4 The case studies**

At first glance, Panama, the Seychelles, and the Netherlands may not have much in common. Panama is a developing country and one of the world’s oldest tax havens, whereas the smaller Seychelles is a recent entrant in this business, and the Netherlands is an EU member state that rarely features in tax haven lists. However, the one thing that connects these countries is their central role in facilitating international tax flight. The most pressing issue with Panama and the Seychelles is their role in international tax evasion and money laundering, whereas the Netherlands is a major hub for corporate tax avoidance structures. The research involved going through policy-relevant country documents from the three case study countries that the IMF has issued on its country websites and in its archives. As change in any large IOs, such as the IMF, is gradual, the case studies cover the years from 1999 to 2016. The analyses in the next section are mostly based on LoI agreements, Article IV documents, and other loan monitoring documents, as well as occasional Selected Issues papers and Country Reports in cases where they discuss issues that are relevant. The documents are listed in Annex 2.

### **4.1 Panama**

Panama is a developing country, with more than 10 per cent of the population living in extreme poverty and nearly one-fifth being poor in World Bank terms (World Bank 2016). In addition to its tax haven industry, Panama also hosts export processing zones which have commonly been associated with the facilitation of money laundering, especially the Colon Free Zone (Eskelinen and Ylönen 2017). Panama has been dependent on both World Bank and IMF financing. The last loan programme with the IMF ran from 2000 to 2002. Panama has also received several loans from the World Bank’s International Development Association and the International Bank for Reconstruction and Development throughout the 2000s. This section reviews relevant IMF country documents from 6/2000–11/2016, as listed in Annex 2. Additional material was drawn from reports published by the OECD’s Global Forum in 2010 and 2016.

#### *The years 2000 to 2007*

The LoI signed in 2000 (IMF 2000a) was supportive of Panama’s offshore financial sector in a period when the backlash against the first wave of OECD-led work against harmful tax competition was underway, with Panama playing an important role in the effort to block the OECD’s proposals (Sharman 2006). The LoI noted, ‘real progress has been achieved with reform of bank regulation and supervision in Panama’, with a typical set of IMF recommendations, such as broadening the VAT base and reorganizing the tax administration. The Article IV document published in 2001 shared this optimism, arguing that the ‘[s]uperintendency moved rapidly to put

in place sound prudential regulations based on accepted international practice and achieved its goal of inspecting over 30 per cent of the banks', among them a number of offshore banks (IMF 2001: 3). The IMF commended Panama for acting 'expeditiously to pass two laws to fortify the anti-money laundering regime'. 'Know Your Customer' requirements were deemed satisfactory, despite a negative review by the Financial Stability Forum in June 2000. Based on these and other observations, an appropriate regulatory framework was judged to be in place, and its 'rigorous implementation' was needed. However, this was not part of the loan's structural performance criteria.

The Article IV report published in 2002 (IMF 2002a: 30) mentioned that 'reforms in the nonbank financial system have lagged behind those in the banking system'. However, the Article IV report for 2005 (IMF 2006a: 17) labelled Panama as largely compliant with international standards for anti-money laundering and combating the financing of terrorism, with weaknesses remaining in: (i) implementation of obligations 'for insurance companies, other financial and nonfinancial activities, and lawyers; (ii) regulation to ensure that owner information is retained by the resident agent for Panamanian corporations; and (iii) extension of the authority to permit provisional freezing and seizure of assets in all criminal cases'. In 2006, the Article IV report (IMF 2007a: 10) argued that 'Panama's sound banking system will continue to contribute to the favorable outlook'.

In 2007, the Article IV consultation was either not held, contrary to the suggestion in the previous year, or the report has not been published,<sup>9</sup> but other reports from 2000 to 2008 indicate that regulating the offshore business was not a major priority. In subsequent reports, the IMF continued to advocate a typical set of policies, such as reforming tax administration and broadening the tax base. The Article IV report of 2004 (IMF 2006b)<sup>10</sup> noted that the authorities regarded fiscal discipline and transparency as essential preconditions for poverty reduction and job creation, and highlighted the need to promote accountability, transparency and anti-corruption efforts. However, these aims were related to the budget process instead of financial secrecy. The report further noted that 'the new administration's emphasis on fiscal discipline, transparency, and good governance are commendable' (IMF 2006b: 16). Moreover, the financial system was deemed 'essentially sound' (IMF 2006b: 4). Tax evasion and avoidance were mentioned only in passing. A year earlier, the Article IV report mentioned that the tax administration should have the 'legal framework to enforce the law and reduce tax evasion' (IMF 2006c: 18), but without further details.

The recommendations for supervision of the financial sector focused mostly on the banking sector, driven partly by the *Assessment of Financial Sector Supervision and Regulation* that the Monetary and Capital Markets Department of the IMF published in September 2006 (IMF 2007b). It found Panama to be largely compliant in ensuring an effective system of banking supervision with 'clear responsibilities and objectives for each agency involved in the supervision of the banks' (IMF 2007b: 7), and fully compliant with providing adequate resources and a suitable legal framework for supervision. Even though some deficiencies were found in AML, capital markets, and insurance sectors, Panama was deemed largely compliant with global consolidated supervision of internationally active banks. The assessment did not seriously question the Panamanian tax haven industry.

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<sup>9</sup> Article IV evaluations are typically published annually, but frequencies vary. Most IMF documents are also published only with the approval of the member country (Marshall 2009: 6).

<sup>10</sup> The reports are occasionally made public with significant gaps.

After the 2007–2009 financial crisis, the OECD issued its infamous ‘black lists’ of tax havens, which only singled out havens with fewer than 12 bilateral tax information exchange agreements. The 2009 Article IV report (IMF 2009a) highlighted the importance of the prudent monitoring of banks, arguing that the inclusion of Panama in the list ‘poses an additional challenge’, (IMF 2009a: 20) noting that a dialogue with the private sector had begun to ‘address Panama’s inclusion in the list’. The report also noted that the ‘strategy could involve changes to financial industry regulations in line with an earlier agreement with the OECD that had been only partially implemented’. The other options under consideration were ‘limitations to the use of bearer shares, modifications in bank secrecy regulations, and permission to exchange tax information’ (IMF 2009a: 20), in line with reforms that had already been adopted in other jurisdictions. The IMF mission ‘strongly endorsed the authorities’ cooperative approach’ (IMF 2009a: 20). However, these issues did not feature in the main recommendations of this report or the one published in the following year, where the IMF mentioned that the ‘authorities have made substantial progress towards Panama’s removal from the OECD grey list of tax havens’ (IMF 2010a: 12). Overall, the main focus was on areas closer to the IMF’s traditional tax agenda, and the staff welcomed ‘sound tax reforms’ (IMF 2010a: 18).

The IMF’s assessment only started to change in 2011, when upgrading of financial sector regulation, supervision, and infrastructure were elevated as Panama’s key medium-term challenges. The 2011 Article IV report urged Panama to prioritize ‘[i]mprovements in risk-based and consolidated cross-border supervision’, and strengthening ‘the capacity to identify and monitor financial system risks’ (IMF 2012a: 1). This implied bringing financial oversight in line with ‘international best practices’ and ‘upgrading all non-bank segments of the financial system’ (IMF 2012a: 17). Strengthening financial sector governance was needed for managing reputational risks and for being ‘competitive in a broader range of investment and wealth management services’ (IMF 2012a: 17). Moreover, the report noted Panamanian efforts to tighten controls in the Colon Free Zone (IMF 2012a: 15).

These changes did not generate growing pressure. The key issues section in the 2012 Article IV report (IMF 2012b) only noted that the ‘ongoing efforts to upgrade financial sector supervision and strengthen the financial safety net should be accelerated, including by closing existing data gaps, enhancing non-bank supervision and establishing a liquidity facility’ (IMF 2012b: 1). Further, the IMF stated that the authorities were making ‘good progress in strengthening regulatory and supervisory frameworks for bank and nonbank oversight’ (IMF 2012b: 7) and that the legal frameworks for AML were being updated, without any new openings in these themes. In 2013, the IMF also published a tax-related Selected Issues report (IMF 2013a), which did not develop these openings any further. No Article IV report from 2013 exists either on the IMF’s Panama country page or in its online archives.

In 2014, the Legal Department of the IMF published two reports assessing Panama’s compliance with the FATF criteria, whose recommendations influenced Article IV reports published from 2014 onward (IMF 2014a, 2014b). The assessment was based on FATF’s Forty Recommendations from 2003 and the recommendations on terrorist financing (FATF 2003). The assessments criticized Panama’s vulnerability to money laundering, substantial gaps in its regulation, and the limited administrative resources and statistics. Problems created by bearer shares, trusts, and the exclusion of the Colon Free Trade zone and certain key professions (such as lawyers and company services) from AML measures were noticed. The reports also included extensive, detailed sets of recommendations regarding key areas of the FATF standards.

The key issues section of the 2015 report noted that ‘delayed reforms to financial transparency are an important risk that could restrict access to global capital and the international payments system’ and that it is essential to strengthen the AML regime, as well as implement the remaining action points from the 2011 Financial Sector Assessment Program (IMF 2015a: 1). However, the staff also ‘commended the authorities for their significant efforts’ (IMF 2015a: 10). Finally, the 2016 Article IV report (IMF 2016b) continued urging the authorities to strengthen the AML regime, noting also Panama’s removal from FATF’s ‘grey list’ where it had been since 2014. The Panama Papers scandal was mentioned several times in the report, for example through reputational risks. The report also noted Panama’s poor ranking in the Financial Secrecy Index and its shortcomings in automatic tax information exchange.

### *Summary*

The IMF country documents for Panama paint an interesting picture. Considering the relatively high attention to various AML and tax-related issues in the reports and assessments published in 2015 and 2016, many things have changed since 2000 when the LoI document commended ‘real progress’ with bank regulation and supervision. In addition to being late, however, the most striking aspect of the recent IMF tax policy advice for Panama is the absence of almost any references to the recommendations by the OECD’s Global Forum. Whereas AML assessments feature prominently in several Article IV reports, the recommendations of the OECD’s Global Forum are mentioned only briefly in the Article IV report of 2016 (IMF 2016b). This is surprising, given that the Phase 1 assessment of the Global Forum for Panama had already been published in 2010. As demonstrated in the following section, the Global Forum recommendations have been influential in the IMF work in Seychelles.

Many of the recommendations in the 2010 Global Forum peer review (OECD 2010: 61–65) criticize the Panamanian secrecy regime, calling for: 1) strengthening the identification of the owners of bearer shares; 2) granting the authorities power to identify the person on whose behalf the shares held through nominees are registered; 3) amending the ‘know your client’ rules for resident agents to identify all key personnel and beneficiaries behind companies and foundations; 4) strengthening penalties for failing to maintain up-to-date stock registers; 5) extending the record-keeping requirements to all companies and partnerships; 6) clarifying the record-keeping requirements for trusts and foundations; 7) signing agreements for exchange of information with all interested partners; and 8) ensuring that professional secrecy rules do not prevent the disclosure of information for exchange purposes beyond the limits permitted in the international standards. While some of these demands also featured in AML assessments, the Global Forum assessments go much further.

By way of a conclusion, three things stand out. First, the standard IMF tax policy recommendations (such as broadening the tax base) have featured regularly in the executive summaries and other sections of various reports from 2000 to 2016. Second, however, concerns related to the AML and anti-tax evasion issues have only started to receive more attention very recently, driven by assessments of the IMF’s legal department. Many of these demands have relied on the criteria developed and updated by FATF.<sup>11</sup> Third and most crucially, in its policy advice, the IMF has completely bypassed the scathing peer review that the OECD’s Global Forum published in 2010 (OECD 2010)—in contrast with Seychelles, where these peer reviews have featured prominently.

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<sup>11</sup> The Article IV report of 2015 (IMF 2015a) is, however, an exception. While aligned with the FATF assessment, the 2011 Financial Sector Assessment Program, and the staff commending ‘the authorities for their significant efforts’ (IMF 2015a: 10), the concerns brought up by the Panama Papers scandal were also addressed.

There are no objective grounds for the IMF to decide to take a more stringent position in Seychelles than in Panama. To highlight just one example, Panama ranks 12th in the Financial Secrecy Index, while Seychelles ranks 72nd. Panama's higher ranking comes mostly from being a heavyweight in the global offshore industry, but it has also been deemed to be more secretive than Seychelles. If the IMF wants to be serious in its global effort to tackle secrecy regimes, it would make much more sense to put at least as much weight on its work in Panama as in Seychelles—or more.

## 4.2 Seychelles

Seychelles is a small republic with 115 islands located some 1,500 km east of mainland Africa. With some 90,000 inhabitants on 451 km<sup>2</sup>, it has the smallest population in Africa. Gaining independence from the United Kingdom in 1976 and establishing a constitution in 1993, Seychelles started its rise to become a major African tax haven in 1994 with the introduction of the Seychelles International Business Companies (IBC) Act. Subsequently, over 100,000 IBCs have been registered (Seychelles Offshore 2017). Seychelles has also become known for providing many other instruments for tax evasion and money laundering. The gross domestic product per capita is US\$28,000, comparable to that of Poland and Portugal (CIA 2017). Despite this and the fact that Seychelles has the lowest poverty rates outside the OECD countries, Seychelles has been taking several loans from the World Bank Group from the mid-1980s onward (World Bank 2017). Since 2008, Seychelles has also been indebted to the IMF (IMF 2017a). In Seychelles the IMF has drawn both from AML assessments and peer reviews of the OECD's Global Forum. Article IV reports were available annually, with the exception of 2001 and 2007.

In 2000, the Article IV report saw the financial sector in Seychelles as 'essentially sound' (IMF 2000b: 19). Acknowledging that Seychelles was an offshore financial centre,<sup>12</sup> the report highlighted that the 'authorities have undertaken a number of reforms, strengthening their fight against money laundering activities', which 'has helped improve the international reputation of Seychelles in this area as evidenced by the recent endorsement given to the country by the FATF' (IMF 2000b: 19–20). The Seychellois request for the IMF's technical assistance 'to assess and strengthen their offshore sector legislation' was also noted (IMF 2000b: 20). However, in an Article IV report covering the year 2002, the 'authorities stated that their growth strategy included developing a more extensive' and 'clean' offshore financial centre (IMF 2002b: 13). In the same year, the IMF also performed its assessment of the Seychellois financial sector regulation, which was published in 2004 (IMF 2004a).

In 2003, the IMF commended Seychelles for making 'progress in establishing a credible supervision framework', even though 'additional steps are necessary to bring the legal and regulatory system in line with international practices and standards' (IMF 2003: 14). The report noted that the aforementioned '2002 Offshore Financial Center Module 2 assessment by Fund staff found only moderate compliance with international standards for anti-money laundering' (IMF 2003: 14). Surprisingly, the Article IV report published in 2004 (IMF 2004b) did not discuss these themes, but in 2005 the Article IV report noted how 'a body for the supervision of nonbanking financial services has been established at end-2005, and the Anti-Money Laundering (AML) legal framework is being finalized', resulting in the establishment of a Financial Intelligence Unit (IMF 2006d: 20) which began its operations a year later (IMF 2007c: 11–13). The 2006 Article IV report (IMF 2007c) included the strengthening of the AML framework as a structural

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<sup>12</sup> The term 'offshore financial centre' is typically used as a more positive term for a tax haven. In this context, 'onshore' refers to states and practices that are not associated with tax havens (Palan 2003).

benchmark, although it is not entirely clear from the document which year the benchmark was established.

### *The 2008 loan programme*

In 2008, the IMF initiated a loan programme with Seychelles, and the Eastern and Southern Africa Anti-Money Laundering Group—a FATF-styled regional body—published its mutual evaluation report on the Seychellois efforts towards AML and combating the financing of terrorism (ESAAMLG 2008). The Seychellois AML Act had been amended in 2006 to establish a Financial Intelligence Unit (FIU), but this did little to curtail the growth of the Seychellois offshore industry. The AML assessment did include several smaller criticisms, but it concluded (ESAAMLG 2008: 22) that, overall, Seychelles ‘has put into an adequate legal and regulatory regime to address’ money laundering and terrorism financing threats. The assessment was based on older FATF criteria than the one currently in use.

The LoI distributed with a review document published in April 2009 (IMF 2009b: 50) called for ‘a fundamental review of the tax system’, but excluding the offshore sector. It criticized ‘high overall tax rates for business’ and also ‘a significant number of exemptions, particularly for foreign investors’ (IMF 2009b: 50). The LoI also urged performing tax audits in the 20 largest enterprises. This became a structural benchmark criterion in the LoI published in 2009, in addition to the adoption of a tax policy reform strategy and amending the Business Tax Act. The 2008 LoI highlighted the importance of transparency, but only in the treatment of potential investors. Several reports emphasized the need to improve financial markets, but not in the context of offshore companies.

A LoI published in June 2009 highlighted progress in advancing the traditional IMF tax agenda (IMF 2009c: 28–29), noting also the ongoing amendment process of the Financial Institutions Act with technical support from the IMF (IMF 2009c: 33). This became a structural benchmark criterion, in addition to the amending of the Business Tax Act. While the Act improved the oversight of trusts and some other company forms, it was not comprehensive enough. As the 2011 peer review of the Global Forum (OECD 2011: 35) noted, foundations are expressly outside the scope of the Business Tax Act and its tax and information obligations. Moreover, the Act did little to address the secretive IBCs.

### *The Global Forum peer review*

The LoI published in June 2010 noted (IMF 2010b: 32) the continuation of Seychellois efforts to promote transparency in its offshore sector ‘through strengthened supervision by the central bank’ and other authorities. The Global Forum peer review was underway, and a LoI published in December 2010 noted that Seychelles had signalled to the OECD’s Global Forum its commitment to promote ‘transparency and exchange of information’ (IMF 2011b: 58). However, this was not reflected in the structural benchmarks for 2010–11. A LoI published in May 2011 (IMF 2011c) reviewed initiatives launched after the peer review (OECD 2011). The IMF noted (IMF 2011c: 43) that ‘a new Companies Act will unify the existing “dual” system’ of onshore and offshore acts, providing ‘a stronger regulatory framework’. Moreover, it highlighted the negotiation of new bilateral information exchange agreements with the Nordic countries and the Netherlands, as well as regulations catering for the ‘obligations to exchange information with third countries’.<sup>13</sup> The

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<sup>13</sup> At the time, the OECD promoted signing bilateral tax information exchange agreements that were based on exchange of information on request, in contrast with the OECD’s newer automatic exchange of information also under a multilateral convention (Meinzer 2017).

establishment of a Financial Services Commission was also applauded as a tool for ‘enforcing transparency of the offshore sector’ (IMF 2011c: 43). Finally, it highlighted progress in implementing the recommendations of the earlier AML evaluation. The IMF’s assessment weighted the Seychellois responses with the criticism it had received from other IOs (Global Forum), but these action points were not included in the IMF’s structural benchmark criterion.

While the next LoI (IMF 2012c) mostly reiterated the ongoing work, in May 2012 the IMF noted that the ‘FIU is in the process of recruiting more staff to increase efficiency and speed up the resolution of cases’, and that amendments were underway for new legislation ‘governing offshore financial sector activities such as trusts and funds, as well as their taxation’ which should also facilitate international coordination, including through Seychelles’ entry into the Egmont group (IMF 2012d: 32).<sup>14</sup> These notions were repeated in the LoI published in November 2012 (IMF 2013b). Banking sector regulation had also featured regularly in LoIs, but mostly from the viewpoint of the Basel recommendations, with little or no mention of the regulation of offshore banks and the investment vehicles that they market to their clients.

The LoI published in November 2013 (IMF 2014c) was narrower than others, but the May 2014 LoI noted that the government had recruited specialized audit personnel ‘to strengthen its investigative and auditing function’ and that it was ‘taking measures on international tax cooperation’ (IMF 2014d: 48). Furthermore, the newly created Financial Service Authority was seen to have a key role for ‘regulating offshore financial services’ such as IBCs, trusts and foundations’. The LoI also stated that the new Financial Services Authority differed from its predecessor (International Business Authority) in not promoting offshore services. Regarding tax cooperation, the LoI noted the Seychellois ‘intention in becoming a signatory to the Multilateral convention on Mutual Administrative Assistance in Tax Matters’, as well as continuing its efforts to reform regulation of trusts, IBCs, and other vehicles (IMF 2014d: 58).

#### *International tax cooperation emerges as a performance criterion*

The IMF has a long history in giving AML-related technical aid to Seychelles. However, in May 2015, international tax cooperation made its first appearance as a structural benchmark. Specifically, the LoI (IMF 2015b) required a ‘submission to the National Assembly of (i) amendment of Seychelles Revenue Commission Act to be consistent with international standards, and (ii) ratification of the Multilateral Convention on Mutual Administrative Assistance in Tax Matters’ (IMF 2015b: 30), and a ‘submission to National Assembly of new legislation on International Business Companies consistent with international standards’ (IMF 2015b: 31). The government’s efforts to enhance its capacity to monitor and enforce transfer pricing of large MNEs and the admission of Seychelles as a candidate for the Extractive Industries Transparency Initiative were also mentioned (IMF 2015b: 63, 68).

The LoI published in December 2015 mentioned a forthcoming evaluation against the FATF standards (IMF 2016c: 38) and several new obligations for corporate service providers, such as strengthening sanctions for non-compliance, prohibiting bearer shares, obliging IBCs to declare their compliance with ownership and accounting regulations, obliging service providers to maintain the share registers in their offices in Seychelles, strengthening the supervisory powers, increasing the number of inspections to IBCs, and applying penalties for non-compliance (IMF 2016c: 40). These measures gave Seychelles a ‘largely compliant’ label from the OECD’s Global Forum, which also published the second part of its peer review of Seychelles in 2015 (OECD 2015). The LoI from December 2016 added a few details, such as new regulations for the bonded

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<sup>14</sup> Egmont group is an informal network of national financial intelligence units.



warehouses. The structural benchmarks were extended by a requirement to submit a ‘new legislation on International Corporate Service Providers and Trusts consistent with international standards’ and by a ‘cabinet approval of a strategy to tackle AML/CFT risks, drawing on the National Risk Assessment’ (IMF 2017b: 52).

### *Summary*

Especially since 2015, the IMF tax policy has drawn from a broad range of outside assessments in Seychelles, focusing on compliance with *both* the FATF and the Global Forum criteria, even though both criteria have their faults (see Meinzer 2017 on the Global Forum). However, it should also be noted that these issues have only recently featured in the structural benchmark criteria.

### **4.3 The Netherlands**

The Netherlands provides an interesting contrast to the two earlier case studies. Overall, the Dutch AML legislation is largely aligned with the FATF criteria, and the government has a long tradition of participating in international tax information exchange. Yet, many scholars (Dharmapala and Hines 2009), politicians such as Barack Obama (Expatica 2009), non-governmental organizations (Oxfam 2016) and the media (*The Economist* 2015) have perceived the Netherlands as a major haven for transnational corporate tax avoidance, which erodes tax revenues in other countries. For this reason, ‘fostering policies and transparent institutions that advance’ the mobilization of domestic resources (Development Committee 2015a, 2016) would require addressing the special laws in the Netherlands and other holding company hubs.

There are several reasons why MNEs find the Netherlands so attractive, the first being the large network of bilateral tax treaties with other countries. In April 2017, the government had tax treaties with nearly 100 jurisdictions (Belastingdienst 2017). Even though some treaties have been renegotiated in the 2000s, they still ‘strongly reduce the treaty partners’ standard withholding tax rates, or eliminate them, for payments to Dutch entities’ (Weyzig 2013: 8). In 2013, only six of the 47 treaties that the Netherlands had negotiated with low- and middle-income countries outside the EU contained anti-abuse provisions for interest and royalties (Weyzig 2013: 8). Moreover, it is relatively easy to repatriate profits from Dutch subsidiaries to parent companies under the EU’s Parent-Subsidiary Directive or tax treaties. MNEs can also gain tax benefits from Dutch advance pricing agreements that lock in the prices used for taxing intra-firm trade for certain periods of time (Ylönen and Laine 2015).

Recent years have seen several case studies where the Netherlands has been used for profit shifting (e.g. Hearson and Brooks 2012; Ylönen and Laine 2015). Consequently, there have been plenty of arguments pointing out the inconsistencies in the Dutch development policies: on the one hand, the Netherlands has for a long time been a staunch supporter of key development policy targets, but on the other hand its tax systems have clearly hindered other countries’ efforts to mobilize their domestic resources. As Weyzig (2013: 13) has argued, the Dutch tax policies are harmful ‘because they are incoherent with the aims of Dutch development policy and against the interests of developing countries’.

### *No mention of BEPS in Article IV reports of the Netherlands*

The incoherence between Dutch development and tax policies makes it interesting to ask how the IMF has approached these issues. Even though it has issued a dedicated report on tax issues in the Netherlands, this and other reports have bypassed its position as a major enabler of tax avoidance. When the reports discuss these themes, the referral point is either money laundering or broader international developments. The first mention of the Dutch money laundering regulations was in

an Article IV report published in 2002 (IMF 2002c). In 2011, the Legal Department of the IMF also conducted a major assessment of the observance of the FATF recommendations, whose follow-up actions were then monitored in the following Article IV documents. As important as these analyses and recommendations are for AML purposes, they do not address the key issues that maintain the country's status as a major holding company hub. At best, they included criticism of the difficulties in identifying the ultimate beneficial owners of some companies (e.g. IMF 2011d: 6).

For these reasons, the Article IV reports fall short in addressing BEPS or in fostering policies and institutions that help with mobilizing domestic resources, even though several Article IV reports had dedicated sections not only for tax issues but also for international tax competition and cross-border spillovers (IMF 2011d: 7). Regarding the former, a selected issues report published in 2008 (IMF 2008) discussed tax competition from the viewpoint of the new EU member states, maintaining the concern 'about governments competing to undercut each other's corporate income tax (CIT) rates to attract mobile tax bases' (IMF 2008: 37) as the new member states generally have lower CIT rates than the old member states. Tax competition was seen as a phenomenon that takes place with tax rates and from which the Netherlands would suffer rather than facilitate it.

This being said, the selected issues report (IMF 2008: 43) noted that 'the Netherlands may have benefited from international profit shifting' through its generous corporate tax regime, and particularly its 'attractive holding company tax legislation'. What is more, the Article IV report (IMF 2007d) published a year earlier noted that re-exports 'would appear very competitive in light of their strong growth', implying that at least some transactions are routed through the Netherlands for tax reasons. However, these remarks were rather marginal and omitted development aspects. The 2015 Article IV report was the first to explicitly discuss BEPS (IMF 2016d: 10). However, it was purely descriptive, explaining the modifications to the Dutch Corporate Income Tax Act to comply with the BEPS requirements, and also discussing country-by-country financial reporting (Murphy 2016) requirements for national corporations and international tax information exchange. The coverage in the Selected Issues paper on tax reform in the Netherlands was even smaller. A number of Article IV reports also applauded the commitment of the Dutch government for official development aid (IMF 2007d: 17, 2008: 21)

### *Summary*

The IMF has neglected the role that the Netherlands plays in international corporate tax flight. While one could argue that the Netherlands does not have any loan programmes either with the World Bank or the IMF, the IMF has nevertheless issued and monitored policy recommendations to the Dutch government in various reports. Hence, should the IMF be serious about its commitments to tackle corporate tax flight from developing countries, it should address the international structures in which the Netherlands plays a significant role.

## **5 Discussion**

More than a decade ago, Mick Moore (2004: 8) noted that 'taxation issues have been far less prominent on the public political agendas in the South than within the OECD'. Since then, international tax issues in general and tax avoidance and evasion in particular have emerged onto the development agenda (Durst 2010; Mehta and Siu 2016). The IMF has recently started to catch up with these developments. However, the case studies presented here show that its responses have been heavily tilted towards AML issues at the expense of tackling corporate tax avoidance or

bottlenecks in international tax information exchange. Moreover, the country-level policy advice has been inconsistent. The OECD's Global Forum reviews have been an important source of IMF policy advice in Seychelles, but not in Panama. This has resulted in more positive assessments of Panama and an unequal treatment of countries. What is more, the Netherlands country reports have completely bypassed its role in facilitating international tax flight, despite a large body of research and policy debates around the Dutch corporate haven.

All of the case studies highlight the dependency of the IMF on policy assessments made by other IOs. Moreover, they underline the dependence of the IMF country teams on the assessments performed by the IMF's other departments. The resulting path dependencies and restraints stress the soft power of international assessments and indices for global governance. An interesting question is whether this approach is enough for the IMF's new commitments to tackle international tax avoidance and evasion. The results are most likely only as good as the underlying criteria of the Global Forum, FATF, and the OECD, which is highlighted by the half-hearted efforts to tackle corporate tax avoidance. Interestingly, the OECD's BEPS recommendations were only mentioned at a very general level and were not utilized for policy recommendations in any of the three jurisdictions. The IMF's Articles of Agreement highlight its role in 'the expansion and balanced growth of international trade', and the tax policies of the Netherlands and other corporate havens distort this balance (IMF 2016 [1944]: 2).

Even if the IMF had utilized all available outside assessments (the OECD, Global Forum) in all of the case study countries, the deficiencies in the original criteria would have resulted in significant loopholes. However, an alternative approach would require the IMF to significantly build up its own capacity and assessment tools in all of these areas, competing and overlapping with the work conducted by the OECD, FATF, and other bodies. There are no easy solutions to this dilemma. However, it underlines the need for an international dialogue that goes beyond simplistic directives and policy statements and takes seriously the loopholes left in the existing initiatives.

The case studies underline the need for bottom-up analyses of the IMF work, in addition to the birds-eye perspective adopted in many of the mainstream studies of the IMF. As Adler and Pouliot (2011:1) have argued, by focusing on practices in IR, 'we can understand both IR theory and international politics better or differently'. Constructivist and post-structuralist studies on the IMF have contributed to this endeavour by highlighting the worldviews and norms of different actors in the IMF (Chiewroth 2015) and the importance of understanding country-level variations in the IMF policy advice (Broome and Seabrooke 2008). However, the problems in the mainstream approaches go deeper than that, as illustrated by Figure 1 (see Section 1), which portrays a very simplified form of influences that have resulted in the policy recommendations that the IMF has given in the three case study countries. From that figure we can see that even though large member states have a key steering role in providing policy alignments, they are influenced by transnational advocacy networks. By the time these policy alignments are turned into concrete actions, they are influenced by other departments of the IMF and—significantly—by other IOs.

Furthermore, the case studies have important implications for the emerging body of international political economy-related tax research. So far, most of this research has analysed international tax governance as a separate sphere of global governance, facilitated by tax-specific work in dedicated departments of the OECD, the UN, and elsewhere. Complementing an earlier case study on the trade-tax nexus (Eskelinen and Ylönen 2017), the case studies presented there underline the important inter-linkages between tax governance, politics of debt, and the overall economic policy monitoring conducted by the IMF and other IOs.

## 6 Final remarks

There is a need for a better understanding of how the IMF shapes international tax governance together with other IOs working in this and related areas. This would call for more country-level case studies. Overall, the IMF's work has received hardly any attention in the recent literature on global tax governance, which hinders our understanding of the scope and capabilities to address the underlying concerns.

Regarding the limitations of this paper, it should be noted that there has been much debate on whether the IMF interventions in its member states are just, and if so, under which conditions, but, unfortunately, space constraints do not allow a thorough discussion of these matters here. However, at a general level it can be said that international tax avoidance and evasion poach the tax bases of other countries; for this reason, the relationship between national sovereignty and outside intervention is potentially more complicated than in, say, privatization of state-owned enterprises. This issue would merit more research. Moreover, the three countries assessed here are only a small sample of the world's tax havens. Broader case studies would certainly be useful in highlighting the variations and nuances in the IMF policy advice on tax havens.

Finally, the research material employed in the case studies does not enable a conclusion to be drawn about why the IMF chose to neglect the Global Forum peer review in Panama even though it utilized the Global Forum assessment's recommendations in Seychelles, or why the Netherlands was treated so light-handedly. There may be various factors behind these decisions, including how forthcoming the authorities were in these jurisdictions, the composition of country teams, and so on. This would merit in-depth country-level studies based on interviews and other material.

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## ARTICLE

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OPEN

# Cities as world-political actors? The “tax haven-free” cities initiative and the politics of public procurement

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**ABSTRACT** In recent years, interest in the world-political role of cities has grown. The use of public procurement for promoting world-political goals has also gathered scholarly attention, as has the tax justice policy agenda. This article contributes to these discussions by demonstrating how global responsibility became part of the city of Helsinki’s policy alignments, which were then turned into several concrete initiatives. In particular, I focus on the contrast between the relative ease with which Helsinki became a “Fair Trade” city on the one hand and the difficulties it faced in its attempts to become a “Fair Tax” city on the other. I argue that that these initiatives illustrate how cities can utilize public procurement to promote world-political goals. I also show how the increasing complexity of the required procurement criteria can make the success contingent on help from “emergent entrepreneurs” of social movements. These developments highlight the contradictory and complex effects of the “economization” and “marketization” of the political sphere. While economization isolates many societal issues from political control, it can also allow for politicizing local and global issues in ways that were unthinkable. Finally, adding to the existing research on the world-political role of cities, I demonstrate that a city does not need to be a metropolis in order to act in world politics.

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## Introduction

This article analyses the dual role of cities in world politics through their procurement activities. Cities can act in world-political arenas in their own right in addition to providing a platform for social movements to leverage their campaign activities. However, I will show how the ease of harnessing public procurement for these purposes depends on the level of economization and the complexity of the required procurement criteria. The more complex the needed criteria is, the more likely it is that social movements and city-level decision makers will need help from “emergent entrepreneurs” (Seabrooke and Wigan, 2015) who can provide them with the required technical expertise. These are relatively new domains of research. The academic literature on the world-political role of cities is scarce, and the role of procurement activities in these processes has received even less attention. Even though tax policies have already started to gather attention in world politics for some years,<sup>1</sup> the majority of the scholarly literature on tax justice campaigns is very recent (for example, Lesage and Kacar, 2013; Seabrooke and Wigan, 2013; Seabrooke and Wigan, 2015).

One of the few scholars who has written extensively on cities as political actors, Acuto (2009: 175), has tellingly noted how “it is possible to count international studies publications concerned with the city as a site of global influence on the fingers of a hand”. I will argue that scholars of political science and world politics would benefit from a better understanding of the procurement activities in an era when issues that have traditionally been considered political have become increasingly economized (Çalışkan and Callon, 2009). This is highlighted by the fact that within the European Union (EU), the public procurement represents nearly one-fifth of the gross domestic product (European Commission, 2014). Hence, I will argue that both the rules governing procurement tenders and the way they are applied impact not only what kind of products and services are being procured, but also the societal arrangements that govern the production of these products and services. The effects can be observed in developing countries and other places far away from the city’s borders.

I discuss these issues with reference to two international civil society movements and the City of Helsinki (Finland), which has aimed to harness its procurement activities in support of these international developments. Specifically, I will show how under certain conditions, the economized political processes can foster the world-political role of cities and not just limit it, as is usually assumed. I describe how Helsinki began to recognize its world-political influence and the responsibilities it associated with this power and how it has reflected these in its policy alignments and strategies. On the basis of this work, Helsinki decided to become a “Fair Trade city” in 2012 and started to use fair-trade-related criteria in its procurement tenders (City of Helsinki, 2012a). In addition, Helsinki decided to commission an internal report on the possibilities of using tax-related criteria in the procurement tenders. The results were much less encouraging than with the promotion of fair trade. In the end, Helsinki failed to come up with a proposal that would have gathered enough political support and that would have, most importantly, conformed to the EU’s procurement directive—at least for the time being. Importantly, the experience of Helsinki reflected a similar outcome in the city of Malmö, Sweden.

I believe that by focusing on the reasons behind the success of the first initiative and the failure of the second, we can gain several important insights on the world-political role of cities in increasingly economized frameworks of governance. Consequently, this article makes several contributions to the small body of existing literature. First, I present a case study of a city that has recognized its potential world-political influence and

aims to increase it, despite the fact that it can hardly be described as a global economic or political hub. This provides a contrast with the earlier studies that have mostly discussed the world-political role of cities in the context of large metropolises. Second, this example helps us to increase our understanding of the opportunities and limits of using public procurement to promote world-political goals, which often depend on the level of abstraction and the complexity of the required procurement criteria, as well as possible help from the “emergent entrepreneurs” of social movements. While key scholars in this field have mentioned the importance of public procurement when discussing the world-political role of cities, I go further by discussing the double role of public procurement in both constraining cities and enabling them to address world-political goals. Third, I analyse the interconnections between the world-political role of cities and other world-political actors, especially social movements. I will argue that the analyses of the world-political role of cities and social movements alike would benefit from more nuanced studies of these relationships.

The research material consists of documents issued by the city of Helsinki, the Tax Haven Free Cities initiative, the Fair Tax Mark foundation, city of Malmö and other relevant actors. The material includes strategy papers, board and council resolutions, and Helsinki’s Global Responsibility strategy. I also conducted a semi-structured interview of the *primus motor* of the initiative in Helsinki, Thomas Wallgren, who is a city council member from the social democratic party and a lecturer in philosophy with a long experience in social movements. In addition, I have gathered information by discussing the initiative with city council members from competing political parties. Finally, discussions and presentations in a seminar on public procurement and taxation organized in Helsinki in April 2015 contributed greatly to this article.

I begin the article by reviewing and discussing the body of literature focusing on the role of cities as actors in world politics. I then continue by introducing the key studies of the use of procurement to promote social goals. Subsequently, I demonstrate how Helsinki managed to use public procurement to promote fair-trade-related goals, but failed to utilize public procurement for tax-related criteria (again, at least for the time being). In the final discussion section, I demonstrate how lessons from Helsinki can contribute to the small body of existing research on the world-political role of cities and the role of public procurement in promoting political goals.

## Review of the earlier literature: sites of action or actors in their own right?

The role of cities in the global economy has gathered increasing scholarly attention in recent decades. Spearheaded by the work of Sassen (for example, Sassen, 1991; Sassen, 2000), several scholars have studied the role of cities in the global economic system. Sassen has argued that by including cities in analyses of the global economy, we can add to “our focus from the power of large corporations over governments and economies” to “the range of activities and organisational arrangements necessary for the implementation and maintenance of a global network of factories, service operations, and markets”. This conceptual shift helps to analyse places that are associated with the activities of the global network (Sassen, 1996: 88).

Building on the Sassen’s concept of the “global city”, a school of comparative research has emerged, evaluating and ranking cities according to their importance and efficiency in global networks (Calder and de Freytas, 2009: 80). These studies have typically focused on cities as sites, hubs and facilitators in the networks of economic and financial globalization. While this approach can



provide much important information on the workings of the global political economy, it is less useful in illuminating the possibility that cities could also be actors in global politics in their own right, as Calder and de Freytas (2009; see also Walker, 2010: 209) have correctly pointed out. This has resulted in a situation where cities are seen to have a central role in economic and financial globalization, though they may lack the power to influence the economic processes they host and facilitate. While this holds true in some cases, it can hardly be taken as a universally applicable fact.

Sassen's critics have pointed out how cities have become active in attempts to tackle climate change (Acuto, 2013), as well as other policy processes that are conventionally understood to belong to the sphere of world politics. Hence, Calder and de Freytas point out that while "the comparative assessment of the social and economic dimensions of global cities" conducted by Sassen and her followers has been important, "systematic analysis of their political functions remains underdeveloped" (Calder and de Freytas, 2009). This article presents one attempt to develop a more systematic analysis of the political functions of cities and their interaction with the civil society organizations and movements. In order to do that, I argue that we should critically review some common perceptions that have so far been put forward as answers to this challenge. In an attempt to develop a more nuanced analytical framework, Calder and de Freytas (2009) introduce the concept "global political city" as one that "exhibits the broad characteristics of a global city, as conceptualized by Sassen", but that also serves as a "micro-setting for global political transactions". According to Calder and de Freytas, the key elements of these global political cities are:

- (1) Being a policy hub and exercising disproportionate influence on global policy debates;
- (2) Having a political-diplomatic community, with dense networks of official and non-official actors shaping global affairs; and
- (3) Functioning as a strategic information complex, within which important political, military and country-risk information of global importance. (Calder and de Freytas, 2009: 81)

Calder and de Freytas analyse the concept of global political cities by discussing the historical hubs of Rome, Baghdad, Paris, as well as current power centres such as Brussels and Washington D.C. On the basis of these examples, Calder and de Freytas (2009: 94) conclude that their case study "illustrates how cities can potentially influence the overall profile of international affairs". However, the problem with this approach is that it does not radically differ from the earlier analyses on cities as sites of political action. This has also been highlighted by Acuto, who has criticized Calder and de Freytas by stating that despite the promises of their title, "which uses the term 'actors' to indicate participation of global cities in international affairs, the article does little to theorize agency" (Acuto, 2009: 175). He argues, in my view correctly, that "global cities are not solely *places of*, but also *agents in* global governance and world politics" (Acuto, 2009: 175). This implies that "studying the city as an *actor* means allowing for that actor to be a participant in the phenomena international scholars tackle on a daily basis, ranging from security and political economy to the environment and human rights" (Acuto, 2009: 175).<sup>2</sup>

This calls for the challenging question of what it means to "act" in world politics. If one adopts a narrow view of politics, this would probably mean acting within the established frameworks of international governance, for example, in international negotiations or bodies. This approach directs attention to formalist and traditional state-centred conceptions of politics and international relations. These conceptions have become outdated at least since

the growth in the past decades of private transnational governance, as well as international non-governmental organizations and movements. Therefore, we need to focus not on the form of the actors in the international arena, but rather on these actors' substantial impacts on the "struggle over the resources and arrangements that set the basic terms of our practical and passionate relations", as Unger (1987: 145–146) has defined politics in its broader sense.

Acuto (2009, 2013) adheres to a similar view by analysing cities as actants (places of action) and actors in international arenas. However, he does this by associating the size of big cities (global cities) with their potential to influence global affairs. While it is most likely that a correlation exists between these two, I believe it would be unwise to assume (even implicitly) such a correlation. In an international arena occupied not only by states but also by NGOs, private actors and informal groups, the political influence of a municipality may arise from active work in international networks even if the city is not a metropolis. This can be illustrated by a comparison with the state-system, where both small and large states can influence international relations, even though the bigger states are more likely to possess greater power than the smaller ones. However, the smaller states generally need to be more creative to exert power over global affairs, for example, by using skilful diplomacy or developing a strategic focus on a few key areas in global governance. I argue that the same logic applies to cities.

Most of the existing studies on the world-political role of cities have focused on city-level diplomacy and action in climate policy. For example, authors such as Kousky and Schneider (2003), Selin and VanDeveer (2007), Andonova *et al.* (2009), and Bulkeley and Betsill (2010, 2013) have gone to great lengths in documenting the role and influence of cities and city networks in tackling climate change. However, less attention has been paid to how cities can use public procurement to promote world-political goals, or be used by social movements for these purposes. Next, I will proceed to discuss this issue.

### Public procurement, world politics and the economization of municipal governance

Understood as "the acquisition of appropriate goods and/or services at the best possible total ownership cost to meet the needs of the purchaser in terms of quality and quantity, time, and location" (Acuto, 2013: 130), procurement has become a major function for municipalities around the world. Moreover, public finance literature has identified procurement activities as one of the four major governmental functions, the other three being providing a legal framework for all economic activities, redistributing income through taxation and spending, and providing public goods and services to the general population (Thai, 2001: 9; see also McCrudden, 2004: 257). Despite the academic- and policy-level interest in connections between public procurement and corporate responsibility, public procurement has received little attention from scholars of political economy. As the authors of the report *Linking procurement and political economy* note, "there are no analytical tools available that link political-economy analysis and procurement" (Frøystad *et al.*, 2010: iii). The work of Acuto has been one exception to this rule, as he has noted that the "logic of public-private hybridization" has "recast the traditional political-economic dependences of these cities on their global market bases" (Acuto, 2013: 131). This being said, there is clearly a need for a better understanding of the relationship between cities, procurement and world politics.

There is a long history of linking public procurement with the promotion of political goals. Social justice issues became interlinked with procurement already in nineteenth century in

the United States, the United Kingdom and France. In 1840, then President of the United States, Martin Van Buren, issued an executive order establishing a 10-hour workday for employees working under certain government contracts. In 1891, the UK Government passed a resolution to ensure “fair” wages for companies working for the government. The primary beneficiaries of these early attempts to include social criteria in procurement tenders were usually male breadwinners. The first major move to widen the beneficiaries was made by the governments of United Kingdom and the United States after World War I, when these governments began to use public procurement to address the needs of people with disabilities (McCrudden, 2004: 257). In the 1960s, requests for racial non-discrimination found their way into procurement tenders. Anti-discriminatory rules were later extended to cover other areas, most notably gender-related goals (McCrudden, 2004: 260–261).

Essentially, early societal goals included in the public procurement tenders were all related to domestic and workplace concerns, and most of these demands later became binding legislation. Things started to change only in the 1960s, when public procurement became a tool for achieving international goals. The most notable example of this development was the widespread campaign against apartheid. This campaign was successful in introducing anti-apartheid measures in public procurement tenders, while also using other means such as consumer and investor pressure. Moreover, the international dimension of procurement also became stronger in the European community, which began to use procurement to prohibit discrimination based on sex in third-country production from the 1970s onward (McCrudden, 2004: 263–264). The work of the International Labour Office also had a role in these developments (McCrudden, 2004: 265).

Developments in the 1980s and the 1990s further expanded the international dimension of public procurement. These events can be seen as the natural evolution of a situation in which the highly developed states had begun to regulate most of the domestic issues by binding legislation. The delivery of public services underwent major structural reforms in various countries as privatization, outsourcing and deregulation became the buzzwords of the time. As a result of this, public purchases of goods and services now correspond to 16 per cent of the GDP in the EU, although there are great variations between countries (European Commission, 2014). No similar statistics exist on the public procurement of municipalities. Nevertheless, it is evident that, collectively, municipal procurement decisions have a major impact on both national and international economies. The growth in the use of public procurement has intensified the critiques against the contractual method of outsourcing, as outsourcing was thought to produce unpleasant social outcomes locally and in other countries. Consequently, the calls have intensified for mechanisms that would address this disparity (McCrudden, 2004: 264). This mood is reflected in demands for better labour norms, human rights and “green” procurement that found their way into procurement tenders in 1990s (McCrudden, 2004: 266).

It is helpful to analyse these phenomena in the context of economization. Callon (1998) has defined economization as “the processes that constitute the behaviours, organizations, institutions and, more generally, the objects in a particular society which are tentatively and often controversially qualified, by scholars and/or lay people, as ‘economic’”. In a somewhat similar fashion, Commons ([1924] 1957, 8) already described in the 1920s how value and economy became verbs instead of nouns; as “value becomes *valuing*; economy becomes *economising*”. Since the 1980s, the wave of privatizations, outsourcings, financializations and other means of extending markets into new spheres (Harvey, 2005) have resulted in the increasing economization of politics in

different parts of the world. The growth of public procurement (Maskin and Tirole, 2008: 1) is obviously one key example of this phenomenon. These economizing processes are typically thought to restrict the sphere of politics. While this is true in many cases, the case studies will show that it is hardly a universal fact.

In principle, the sheer scale of procurement activities should give municipalities and other public agencies an enormous amount of power to use market mechanisms to exert political pressure on states. However, the outsourcing wave has resulted in the insulation of procurement activities from demands that could be deemed as “political”. Especially in the EU, all such demands have to be justified by proving that they relate to the “invisible characteristics” of the product that is being procured. This division line is arbitrary, as the invisible characteristics are, almost by definition, fictional (Commons [1924] 1957: 23–24). Indeed, the power to define which claims could be conceived as “invisible characteristics” of a product has become of paramount importance. Moreover, it should be noted that the level of expertise required for drafting the procurement rules generally increases with the complexity and level of abstraction of the criteria.

The “Fair Trade Cities” movement is an illustrative example of this. Internationally, the fair-trade campaign has been the most successful international attempt to link public procurement with world-political goals. Initiated by NGOs and activists, spearheaded by the international labelling organization known as the Fairtrade Foundation, and fostered by cities that are often members of national fair-trade platforms, this campaign is a symptomatic example of new alliances that can shape the idea of what it means to act in world politics. The concept of fair trade has been evolving over the past 40 years, and it has gained broad support from local, regional and international actors. According to the Fairtrade Foundation, there are over 1.4 million farmers and workers in 1,140 producer organizations across the Fairtrade system. An estimated 7 million people have been said to benefit from fair-trade sales (Bowes, 2011: viii).

The basic idea behind fair trade is well-known. The international certification system aims to ensure better pay and longer contracts for workers on small farms. Moreover, part of the profits should be used for community development purposes. In the EU, there has been a growing interest in promoting fair trade since the early 1990s from the EU level to municipalities (European Parliament, 2012). Cities have been particularly active promoters of fair trade. At a public meeting in 2000, the people of the city of Garsland, UK, voted almost unanimously for Garstang to become the world’s first fair trade town. Soon after this, the Fairtrade International seized upon the idea of a “Fair Trade town” as a device that could be turned into a national campaign (Low and Davenport, 2007; Malpass *et al.*, 2007). At the time of writing, the international network of “Fair Trade town” is comprised of more than 2,200 members in 18 different countries. A city has to meet five goals in order to become a “Fair Trade town” (Fair Trade towns, 2015):

1. Local council passes a resolution supporting Fair Trade and agrees to serve Fair Trade products (for example, in meetings, offices and canteens).
2. A range of Fair Trade products are available locally (targets vary from country to country).
3. Schools, workplaces, places of worship and community organizations support Fair Trade and use Fair Trade products whenever possible.
4. Media coverage and events raise awareness and understanding of Fair Trade across the community.
5. A Fair Trade steering group representing different sectors is formed to co-ordinate action around the goals and develop them over the years.

The 1990s saw a steady growth in the use of fair-trade-related criteria in public procurement tenders. The developments in the EU were of particular importance. In January 1994, the European Parliament (EP) adopted a resolution to promote fairness and solidarity in North–South trade. The EP called for the European Commission (EC) to develop initiatives that would support fair trade, with dedicated funding and the inclusion of fair trade in community development and cooperation policies. In the same year, the EC published a document on Alternative Trade, expressing its support for strengthening fair trade both in the South and the North. Consequently, in 1996 the Economic and Social Committee of the EU welcomed the development of fair-trade-labelling initiatives and called on the EC to create a dedicated budget line in support of fair-trade activities. This request was reiterated in the report on fair trade adopted by the EP in 1998. This report also put forward a number of proposals for further EC actions in support of fair trade (European Commission, 2012).

After several further calls from the EU parliament and committees for the official EU-level support of fair trade, in 2009 the EC introduced its first communication on fair trade. The communication associated the promotion of fair trade with “the sustainable economic and social development of the developing countries, and more particularly the most disadvantaged among them; [with] the smooth and gradual integration of the developing countries into the world economy; and [with] the campaign against poverty in the developing countries” (European Commission, 1999). In other words, already at that time the EC noted how municipal-level procuring activities were connected to world-political issues. The report acknowledged that “many authorities are calling for tenders including sustainable objectives or ‘fair trade’ in their procurement policies” (European Commission, 2009: 9).<sup>3</sup> Furthermore, the communication stated that contracting authorities are free to define sustainability-related procurement criteria as long as they are “linked to the subject-matter of the contract and comply with the other relevant EU public procurement rules, including the basic principles of equal treatment and transparency” (European Commission, 2009: 9). This was a clear statement of political will in support for linking public procurement with fair trade. In other words, one of the biggest players in international relations began to underline the world-political impacts of municipalities long before scholars of international relations began to study this topic.

Despite official support from the EC, the legal status of fair-trade-related procurement criteria has been unclear. In August 2008, a contract notice was published in the *Official Journal of the European Union* for the supply and management of automatic coffee machines from 1 January 2009 onward. Issued by the province of Noord Holland in the Netherlands, this contract notice provoked the EC to send a formal complaint to the Kingdom of the Netherlands on 15 May 2009. According to the EC letter, the specifications stipulated that the contract infringed the EU’s public procurement directive (2004/18) by demanding that the suppliers of tea and coffee adhere to the MAX HAVELAAR and EKO labels. The Court ruled that Noord Holland had violated the procurement directive by demanding that the service providers had to obtain a particular label for their products. In addition, the Court noted that “there is no requirement that an award criterion relates to an intrinsic characteristic of a product, that is to say something which forms part of the material substance thereof”. Essentially, this meant that it was possible to use fair-trade-related procurement criteria as these criteria were understood to be “invisible” characteristics of the product, but only when these criteria were listed in the tender without demanding that the products offered should carry

a particular label (Paragraph 99). This was in line with the guidelines provided in the EC communication.

Helsinki is an illustrative example of a city that has benefited from the Court’s judgment in the area of fair trade. Since the 1990s, the international activities of Helsinki have been guided by international strategies that were succeeded by the Global Strategy in 2012. Helsinki drafted its first international strategy already in 1994 as a “road map for a national capital that was recovering from an economic slump and opening up internationally” (City of Helsinki, 1994). Three consequent strategies then widened the focus by discussing issues such as EU membership, multiculturalism and cooperation within the Baltic region. At the time, little attention was paid to how Helsinki could influence the world-political framework where it operates.<sup>4</sup> In April 2009, the city board of Helsinki adopted a new general strategy for its future work in which it stated that the city would draft a separate strategy for its global responsibility. The mayor convened a working group in September 2009 that presented a draft version of the Global Responsibility Strategy in March 2012. Comments and amendment proposals were then collected from the city board, other municipal boards and the city agencies, and the Global Responsibility Strategy was finally adopted in September 2012 (City of Helsinki, 2012a: 2).

The global responsibility strategy presented a major step towards extending the political role of Helsinki beyond its traditional borders. According to Finnish law, “local authorities shall strive to promote the welfare of their residents and sustainable development in their area” (Local and Regional Government of Finland, 2007: 4). Adopting a creative definition of the “area”, Global Strategy stated that “to be able to fulfill the goals specified in the Local Government Act, the municipalities must be increasingly aware and cognisant of the global operating environment of their own operations and, for their own part, actively strive to influence the global development” (Local and Regional Government of Finland, 2007: 4). In other words, the city made headway in widening its understanding of its own role in the wider global environment.

The strategy included a long list of issues that the city sees as part of its global responsibility. Among these were the local efforts to solve climate change and cross-border environmental protection issues, environmental and social effects, local efforts for promoting immigration and diversity, guidelines for international operations, cross-border measures in connection with the management of finances and the finance market, and measures related to work life and personnel. In addition, respect for human rights, equality, and diversity were mentioned (City of Helsinki, 2012a: 3). Finally, the strategy mentioned the global impacts of the city’s procurement activities. Related to this, in 2013 Helsinki became a “Fair Trade town” and a member in the Finnish network of fair-trade cities.<sup>5</sup>

### The merits and perils of public procurement

The fair trade cities network and Helsinki are helpful examples for illuminating several important and under-studied aspects of economization. Çalışkan and Callon have noted how markets require “generating and then reproducing a stark distinction between the ‘things’ to be valued and the ‘agencies’ capable of valuing them”. Furthermore, they note that two basic types of entities result: “entities with pacified agency that can be transferred as property, and entities that are able to engage in operations of calculation and judgment” (Çalışkan and Callon, 2010: 5). While this bipolar categorization may work with normal market transactions, the Fair Trade cities example illuminates the problems we encounter when this kind of dichotomy is applied to public procurement. Essentially, the marketization of the public



sphere has resulted in a situation where the capacity of the public agencies for calculating and judging has itself been pacified by the procurement legislation. In the public procurement process, municipalities have to give up parts of their regulatory power for companies whose actions they can only influence periodically during the renewal of the procurement contracts, and even then their hands are bound by detailed procurement rules. However, these very same procurement rules create opportunities to widen the definition of “area” the way Helsinki did in its global strategy, and to demand societal standards abroad in a way that would be impossible if the municipality produced the same products itself. In a way, these demands turn the economization process on its head, at least in a limited area. The significance of these concessions can be debated, but they are nevertheless a real, existing phenomenon.

The long and arduous process of getting an unquestioned acceptance of the use of fair-trade-related criteria in procurement tenders is an illustrative example of the merits and perils of using procurement to promote societal goals. Drafting procurement tenders are often difficult, as small inconsistencies in wordings may result in lengthy and costly delays and litigations. Therefore, in the economized municipal policies the possession of this kind of legal-economistic know-how has been elevated to a gatekeeper role. On the one hand, those municipalities, agencies, or even individual politicians or civil servants with access to this know-how may be relatively well-equipped to harness procurement for promoting world-political goals. On the other hand, without this kind of knowledge, the only thing that municipal decision makers can do is, more or less, to adhere to an already established and tested set of “ethical consumerist” demands. In this way, organizations such as the Fair Trade Organisation can also become important gatekeepers. The procurement processes they have managed to get tested in courts have become the “safe” ones for municipalities, while even small deviations from these processes may result in legal battles.

This gatekeeper role can be illustrated by contrasting the fair trade campaign with a failure that another procurement-related initiative faced in Helsinki, namely, the campaign for becoming a “fair tax” city. In its global strategy, the City of Helsinki stated that “the city cooperates with business life to further social responsibility”, continuing that “the city finds it important to prevent the use of tax havens and, thus, avoids cooperation with companies linked to tax havens”. These demands were listed under the section titled “Responsibility in the management of finances and prevention of grey economy”, which stated that the “city is in active cooperation with the tax authorities, other cities, business life and civic organisations, to be able to prevent grey economy both nationally and internationally”, and that “reports on the implementation of the action programme against grey economy are regularly being compiled for the City Board”. Moreover, the strategy stated that “city acts responsibly when it comes to investment activities and getting loan financing” (City of Helsinki, 2012a: 6–7).

However, even proponents of this idea lacked concrete measures for achieving this goal at the time, especially given the constraints imposed by the EU’s procurement directive. Consequently, the city board commissioned a report from the city’s civil servants on issues related to tax havens, with an aim to draw from experiences from other EU countries and to map the ways that municipalities could avoid cooperation with such companies. The report was concluded in 2013, and it noted the impossibility of using “voluntary or mandatory criteria for excluding companies on the grounds that they have connections with tax havens” (City of Helsinki, 2013: 12). The report then discussed different quantitative and qualitative criteria that can and cannot be included in procurement tenders. Regarding this, it

noted that according to procurement legislation, the “purchaser cannot use criteria that would measure the qualities of companies engaging in procuring activities”. For this reason, “it is impossible to utilize criteria that would take into account the company’s connections to tax havens” (City of Helsinki, 2013: 12). Finally, the report noted that it would be very difficult to obtain the relevant country-level financial information from the companies and suggested that the “fair tax” issues are more relevant for discussions of corporate social responsibility.

After the financial crisis of 2007–2009, several municipalities became interested in linking procurement with tax-related objectives. Helsinki and the city of Malmö were particularly active in taking these initiatives to the city board and council levels, but similar developments also took place in France and some other countries. In August 2012, the city council of Malmö decided to examine the possibility of including transparency-related criteria in procurement tenders for companies with linkages to tax haven countries (City of Malmö, 2012).<sup>6</sup> However, in a report published in 2013, the city noted that the City Office had looked into this issue, but there was very little or no opportunity to promote such transparency demands under the current legislation (City of Malmö, 2013). In other words, whereas the Fair Trade campaign had been made possible by the international network, an international dimension alone could not help the fair tax initiative to succeed.<sup>7</sup>

This international dimension included more than informal exchange of ideas. In March 2014, international cooperation geared up as the “tax haven-free cities” network was founded during a conference organized in Stockholm, Sweden. The network gathered the key people who were pushing these initiatives in Finland, Sweden and other countries, and worked as a platform for city-level activists to share information and ideas and to spread knowledge on these topics. It aims for the following:

- Cooperation and transparency instead of the secrecy provided by tax havens, the corporate manipulated accounting and the tax competition between countries
- A public register of companies’ real owners, including all shadow structures like trusts, private foundations and shadow companies
- A global agreement on automatic exchange of information between tax authorities
- Country-by-country reporting by multinational corporations in all sectors showing their financial activities for each country in which they operate to make visible their tax strategies (Taxhavenfreecities.org, 2015)

In addition, the call stated that “local governments in all countries can cooperate and better utilise the possibilities available today to be ‘tax haven free,’ i.e. to prevent tax money from going to companies, banks or other financial institutions that use tax havens for tax evasion”. However, the means for achieving this were left open, illustrated also by the challenges that Helsinki and Malmö faced in their attempts to take the idea really forward. This is highlighted also in a barrister’s opinion that was commissioned by the UK-based not-for-profit company Fair Tax Mark Limited. Founded in order to foster voluntary disclosure of transparent and non-tax-avoiding tax policies in multinational companies, Fair Tax Mark Ltd. wanted to find out whether it would be possible to use their Fair Tax Mark in public procurement tenders. According to the barrister’s opinion:

[The] difficulty comes with the requirement that the labelling criteria (i.e. criteria identifying anti-social tax behaviour as an input to the subject matter of the contract) be objectively

defined. We recommend therefore that the definition of anti-social tax behaviour in this context moves away from the notoriously hard-to-define concept of “tax avoidance,” and focuses instead on objectively identifiable input factors that create tax risk for public exchequers. An example might be the use of tax havens in supply chains. (Quentin, 2013)

In other words, while it could be possible in principle to develop tax- or transparency-related criteria for public procurement under current EU legislation, it would be challenging—but not necessarily impossible—to formulate a set of criteria that connects tax or transparency practices with the product being procured.<sup>8</sup> Procuring is a technically demanding activity, and these difficulties are further accentuated by the corporate secrecy applied in many of the procurement contracts, which makes monitoring the decisions difficult for elected representatives, the media and other watchdogs. The more dependent the city becomes on procuring activities, the bigger the threat will be that it will lose its own expertise and become increasingly dependent on the outside providers.

After the pessimistic conclusions in the aforementioned report Helsinki conducted in 2013, the push for introducing tax-related criteria to public procurement tenders lost some of its steam, at least for the time being. Many parties and politicians were sceptical or hostile towards the initiative from the beginning, and the report confirmed many of their concerns. In other words, the same directive on public procurement that enabled a relatively small capital to join the Fair Trade cities network by adopting a wide definition of its “area” that went beyond the national borders also restricted Helsinki from introducing any measures related to the discrimination against companies based on tax-related criteria. Using the terminology of Çalışkan and Callon, the result was an entity with pacified agency when it came to valuating the financial and tax structures of companies, but an active agency in relation to workers’ rights abroad.

### Reflections: politics in economized cities

Today, some of the biggest political struggles are fought over decisions about whether or not particular services should be outsourced. Politicians are often painfully aware of the fact that after the procurement decision has been made, their power to steer the use of public money reduces significantly. In this manner, public procurement “marketises” issues, processes and structures that have traditionally been associated with the sphere of politics. Çalışkan and Callon describe marketization as a particular case of “economization”, which refers to “the processes through which behaviours, organisations, institutions and, more generally, objects are constituted as being ‘economic’”. Marketization, then, refers to the process of economization by establishing markets. While markets are not identical, they typically organize the conception, production and circulation of goods, as well as the voluntary transfer of some sorts of property rights attached to them’. Moreover, markets “delimit and construct a space of confrontation and power struggles” (Çalışkan and Callon, 2010: 3).

In other words, the conventional understanding of the economization and marketization processes is that they delimit the sphere of politics. However, the case studies presented in this article show procurement activities can also create opportunities to politicize issues that have already been marketized, thus blurring some of the traditional borderlines between local and international, or between markets and politics. In world politics, this also questions the “level of analysis schema” of “man, states and international system”, which has received too little critical appraisal (Walker, 1993: 131; but see also Henderson *et al.*, 2002: 456).

While many of the recent accounts of world politics avoid these sorts of oversimplified categorizations, the discipline has not paid sufficient attention to the pervasiveness of world-political matters in the fields of public procurement and city-level politics.

The example of Helsinki and the Fair Trade Cities network illuminates how any city can promote world-political goals to the extent allowed by the purchasing power of its procurement activities. The scarce literature on the world-political role of cities has so far stressed how large metropolises can influence world-political affairs. While acknowledging that metropolises can in many cases be better equipped for this task, this case study has underlined that factors other than mere size should be taken into account. As Henderson *et al.* have noted, “in order to understand the dynamics of development in a given place, then, we must comprehend how places are being transformed by flows of capital, labour, knowledge, power etc. and how, at the same time, places (or more specifically their institutional and social fabrics) are transforming those flows as they locate in place-specific domains” (Henderson *et al.*, 2002: 438). Helsinki’s example can shed light especially on this latter dimension.

While we should be careful not to overestimate the world-political influence of any particular city’s procurement activities, the sheer scale of public procurement activities means that they can potentially be used for promoting world-political goals. Moreover, procurement processes and regulations have become more standardized, especially within the EU, thus creating more space for international civil society and municipal governance that promotes more “responsible” and standardized rules for public procurement. In addition, many of the companies that participate in procurement tenders operate in many countries, which make it easier for civil society organizations to target potentially irresponsible practices. Procurement criteria can also act as “catalysts” for more far-reaching reforms, as the history of public procurement has shown.

Therefore, the increase in the number of outsourcings and the increasing significance of public procurement play a double role in reshaping the political sphere, not only by restricting the political opportunities but also by expanding them. The former aspect has been documented extensively in the management literature. Outsourcings can restrict the political steering capacities of elected representatives by making the political alignments dependent on contractual formulations that can be altered only when the contract period expires (Kuusela and Ylönen, 2013), and the formulation of tenders requires high-level technical and juridical expertise rarely possessed by the elected representatives (Prince, 2012: 198–199). Outsourcings can also restrict the ability of elected representatives to obtain information from outsourced activities, as the companies providing the services typically operate under private law (Siemiatycki, 2010: 389). Continuing reliance on outside providers can also lead to the deterioration of the municipality’s ability to perform and assess the substantial matter of the procurements, at the level of both the administration and the political representatives (Saint-Martin, 2000). The list of negative aspects of de-politicisation could be continued. In other words, these impacts restrict and diminish the political aspects related to public procurement.

The other, more positive role of public procurement lies in harnessing it to promote world-political goals. Related to this, the comparison between the Fair Trade and the Fair Tax initiatives highlights several interesting aspects. The Fair Trade campaign has been successful in building long-term growth based on raising public awareness, campaigning on different levels of politics, and building technical expertise and easily duplicable models that decision makers can endorse without much technical expertise. Especially since the endorsement from the European Court of Justice, obtaining the Fair Trade Mark has become a relatively

easy goal for both municipal politicians and local-level activists to promote. However, in contrast with the fair-tax initiative, the process was steered by civil society networks with longstanding expertise in this area. Moreover, the idea of using procurement to promote work-related rights also has a long and well-established history, even though the fair trade campaign has added a new, international dimension to it.

The loose campaign for introducing fair-tax-related procurement criteria to procurement tenders provides in many ways a contrasting example. There were two key reasons for the failure of the fair-tax initiative beyond those related simply to the political balance of power in Helsinki (which was also an important factor, as many key decision makers categorically opposed the initiative). First, neither the city's decision makers nor the city officials possessed the know-how required for formulating a procurement tender that could have functioned as a starting point for political discussions of the matter. Second, there was a great deal of uncertainty over whether the possible tax- or transparency-related procurement demands would be compatible with the EU's procurement directive. Both of these reasons highlight the importance of technical expertise in harnessing public procurement for complex societal goals.

However, this situation might be changing. In December 2015, the EP gave a resolution titled "Report with recommendations to the Commission on bringing transparency, coordination and convergence to Corporate Tax policies in the Union" (European Parliament, 2015). Referring to the Fair Tax Mark as a precedent, the Parliament called on the EC to bring forward a proposal "as soon as possible on a voluntary European 'Fair Tax Payer' label", including "eligibility criteria, under which the label could be awarded by national bodies". Moreover, the Parliament demanded that the "Fair Tax Payer" label only be "awarded to those companies that have gone above and beyond the letter of what is required of them under Union and national law", and that "companies should be motivated by this 'Fair Tax Payer' label to make paying a fair share of taxes an essential part of their corporate social responsibility policy, and to report on their stance on taxation matters in their annual report". When the EC discussed the issue in connection with the development of a wider country-by-country reporting initiative, it noted its interest "in further promoting the use of fair tax payer labels as a private market initiative" (European Commission, 2016).

This progress would most likely not have taken place without the active role of the Fair Tax Mark initiative that draws on the expertise of some of the key persons in the Tax Justice Network. The emergent entrepreneurs (Seabrooke and Wigan, 2015) of the network were partially the same people who played key roles in elevating the mandatory country-by-country reporting of multinational companies to the policy agenda of the EU (Seabrooke and Wigan, 2015). This highlights how "ideas are powered through expertise" (Seabrooke and Wigan, 2015). At the same time, the big tax advisory firms are busy developing their own voluntary tax responsibility measures such as the "Total Tax Contribution" of the PriceWaterhouseCoopers, thereby mimicking "the vocabulary of transparency whilst providing no information about its role in tax avoidance, the schemes that it manufactures, the amount of tax that major corporations should have paid, or even the fees that the firm charges for such spin and whitewash" (Sikka and Willmott, 2013).

Finally, it should be noted that even though the labour issues embedded in procuring fair trade products are at first sight more straightforward than the fair tax agenda, this difference is largely illusory. When it comes to the characteristics of a particular product, the labour rights promoted by the fair trade are essentially just as "invisible" as demands related to corporate structures or transparency. This highlights the political role of the

courts of justice in defining what aspects of the capitalist production process and its discontents are characteristics of the products and which aspects should be seen as by-products that can be ignored.

The efforts to link public procurement with tax compliance and transparency continue both in Finland and internationally. In 2015, some of the key people behind Helsinki's tax initiative founded a non-profit organization, which promotes "fair tax" in public procurement and continues to develop demands that would comply with the EU's procurement directive. Internationally, the British Fair Tax Mark has continued to generate interest towards this thematic, even though it is not directly related to the public procurement. Moreover, the payment of taxes has become a growing social responsibility issue, with contestations between businesses and their adversaries over how to define the limits of this responsibility (Ylönen and Laine, 2015).

These kinds of contestations and clashes over private corporate interests and increasingly economized municipal policy-making are likely to increase in the future. One can only hope that the scholars of world politics and global political economy will start paying more attention to these developments and to develop more nuanced theoretical framework and case studies that will help increase our understanding of the linkages between municipalities, public procurement and the world politics.

## Notes

- 1 For example, Eden and Kudrle, 2005; Sharman, 2006; Eden, 2007; Rixen, 2008; Sagafi-Nejad *et al.*, 2008; Rixen, 2010; Nölke, 2011; Palan *et al.*, 2013.
- 2 This is echoed in the thoughts of (Walker, 2010, p. 209), who has noted that "the prevailing traditions of political theory and theories of international relations still assume that cities are where and what they are supposed to be, at considerable cost, I would say, to their claims to scholarly credibility".
- 3 "Contributing to Sustainable Development: The role of Fair Trade and non-governmental trade-related sustainability assurance schemes."
- 4 However, Helsinki had shared its lobbying office in Brussels with some Finnish regional associations and universities since 1996, which was briefly noted in the 2008 strategy (City of Helsinki, 2008; City of Helsinki, 2012b).
- 5 Only four city board members opposed increasing the use of fair trade products and applying the Fair Trade City status, with 75 board members showing their support (City of Helsinki, 2012c).
- 6 The Swedish-language decision stated, "Under överläggningen yrkar kommunstyrelsens ordförande att det görs ett tillägg efter första att-satsen med följande lydelse; att även undersöka möjligheten för att antingen offentlighetsprincipen skall gälla för skattefinansierad verksamhet i välfärdsektorn eller att kunna ställa krav på ekonomisk insyn bl.a. för att undvika upphandling av företag kopplade till s.k. skatteparadis".
- 7 International municipal-level networking activities have not gone unnoticed by the civil society organizations campaigning for tax justice issues. Helsinki's attempts to connect taxes and public procurement have been addressed, for example, by Richard Murphy, senior advisor and one of the founding members of the Tax Justice Network, who praised these efforts in his blog and called for more action in the United Kingdom (Murphy, 2012). In Scotland, both the UK's largest public-sector service union, UNISON, and the Ethical Consumer Association referred to developments in Helsinki and Malmö in their submissions to the Procurement Reform (Scotland) Bill (UNISON, 2012; Ethical Consumer Research Association, 2013).
- 8 However, it should be noted that the public procurement directive was renewed in 2014 and is currently being implemented in national legislations. Of importance is the Article 77, which addresses some public contracts in health, social and cultural services. It includes a clause stating that, under certain conditions, companies engaged in procurement should reinvest their profits "with a view to achieving the organisation's objective" and "where profits are distributed or redistributed, this should be based on participatory considerations" (Paragraph 2b).

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## Data availability

Data sharing is not applicable to this article as no datasets were generated or analysed during the current study.

**Additional information**

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